THE DEVELOPMENT IMPACT OF COUNTERPART FUNDS

A Review of the Literature

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by

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Executive Summary

This paper surveys and evaluates the literature on the development impact of counterpart funds. Counterpart funds are defined as the local currency generated by the sale of commodity aid, including food aid, or cash aid in foreign exchange, over whose use the donor has some control. The paper concludes that the nature and value of the counterpart fund approach differs depending on the country situation. In some country situations this approach offers numerous opportunities for making aid more effective than it would otherwise be, while in others, the counterpart fund approach associated with commodity and cash aid serves no useful purpose and can indeed create significant costs for both donor and recipient.

These conclusions have two important policy implications. In the first place, they mean that it is impossible, and indeed undesirable, to draw up hard-and-fast rules that apply in all countries, under all conditions. The second implication is more demanding. For counterpart funds to be effective, USAID mission staff in the recipient country must have a thorough knowledge not only of the way the aid receiving economy works but also of the institutional, political, and cultural aspects of the society in order to identify any ways in which counterpart funds could be exploited.

The paper begins with an Introduction and contains seven chapters of analysis. Chapter 2 discusses definitions and a brief history of counterpart funds to give a perspective on the current state of counterpart fund arrangements.

Chapter 3 discusses the data and provides some insight into how important, empirically, counterpart funds are in their several roles. The data are far from complete. A.I.D. reports the level of counterpart funds generated by its programs. The IMF, in International Financial Statistics, reports counterpart funds in the monetary survey for some countries. There is little systematic data on counterpart funds generated by other donors' aid programs, or on the uses of counterpart funds. On the basis of the available data, we found that in many countries, counterpart funds are quite small compared to the money supply or government expenditures.

Chapter 4 considers the arguments about whether counterpart funds add much to the effectiveness of the United States aid programs. Opinions on this question range from strong support for the view that counterpart funds constitute a separate and additional development tool to foreign exchange or commodity aid provided, to equally strong support for eliminating the use of counterpart funds altogether. We believe that these views are not as mutually exclusive as the literature implies, as each position may be appropriate for some countries at some points in time. This means that there is no one correct view of the benefits of the counterpart funds process; alternatively, it means that holding one generalized view on the effectiveness of counterpart funds is probably inappropriate. Chapter 6 discusses several general examples of country situations under which different views about the benefits of counterpart funds will hold true.

Chapter 5 studies the various technical issues relating to counterpart funds that have attracted so much attention and are subject to considerable confusion. It starts by presenting the consensus view on the immediate impact effects of generating and programming counterpart funds on the money supply. This is followed by an examination of the available data to attempt to determine whether the monetary effects of counterpart funds are important. It concludes that counterpart funds in many countries are too small relative to the money supply to have any significant effect. In some countries, at some times, the monetary effects of counterpart funds may be important, but in general, the monetary effects are not significant. In countries where counterpart funds are large relative to the money supply, the counterpart fund mechanism has as often as not led to slower growth of the money supply than would have occurred otherwise. In addition, the effect of counterpart funds on the money supply is often small relative to other determinants of money supply growth, such as borrowing by the government from the Central Bank.

This chapter goes on to argue that the aid, together with the counterpart funds, affect the money supply through their impact on the balance of payments and the government deficit. These impacts are often overlooked in the literature, a fact which has resulted in some confusion. The combined effects on the money supply are worked out in detail. Impacts on the government deficit are of interest independently of the monetary channel, and these impacts are also discussed. Available data on the size of counterpart funds relative to government spending are also examined. As was true for the money supply, the size of counterpart funds relative to government spending is, in many countries, so small as to make this issue unimportant. Again however, in some countries and at some times, counterpart funds may be a significant proportion of government spending.

This chapter then goes on to discuss the inflationary effects of counterpart funds. It concludes that counterpart funds need not be and, in general, have not been inflationary. Whether or not they are depends on the effects of the aid and counterpart funds on both the available supply of goods and the money supply. All this suggests that generalized concerns about the inflationary effects of counterpart funds are overstated.

Next, Chapter 5 turns to a discussion of the effects of counterpart funds on the exchange rate. This is a topic little discussed in the literature, but given the effects on the balance of payments and the money supply, models of exchange rate determination can (and should) be used to analyze these effects.

The problems of countries with large balances of counterpart funds are then discussed. Since the recipient country need never spend large accumulated balances, or agree to their use if the local currencies are U.S.-owned, large counterpart fund balances may be more of a political problem than an economic one. Evidence is cited from India's experience with large accumulated balances.

The chapter concludes with a discussion of the problems that arise in deciding how much counterpart funds should be generated for any given amount of commodity or foreign exchange aid.

Chapter 6 contains a series of rather detailed stories. These stories illustrate a number of the issues that bear directly on the effectiveness of the use of counterpart funds and on the way that they should be used in different situations. Four general situations are examined. The first is an economy that has no inflation or balance of payments problems, no government deficit or unemployment, but is abysmally poor. The second is an economy with excess aggregate demand. Two different states of excess demand are identified: in the first, the economy is using all its resources effectively, but aggregate demand is growing faster than available supply, and consequently prices are rising; in the second, there is excess demand but also there are distortions and bottlenecks that prevent the economy from utilizing all of its resources. The third situation is one in which the aid receiving economy is experiencing a balance of payments problem. In the fourth, special considerations regarding the use of counterpart funds are descussed for countries that are at the very early stages of development or that have governments that are especially ill-managed or suffer from widespread corruption.

Under the conditions represented by each of these four stories, the role that counterpart funds can play is studied in detail. It is clear that the way such funds should be used depends heavily on which conditions obtain, and that misunderstanding the nature of a particular set of conditions can lead to a misuse of the counterpart funds. Two points emerge that are especially important. The first refers to the importance of understanding how development takes place, or can take place, in a given country at a specific time. This point is obviously most directly relevant in a country that, although very poor, has no inflation, no budget deficit and no unemployment. In this case, the task is to try to use resources to get productivity growing. Where, however, inflation, deficits and unemployment do exist, the main immediate task may be to eliminate these conditions before going directly to explicit development policies. As a consequence, the appropriate use of counterpart funds will be different from the previous case. Here perhaps they should not be used at all, but sterilized or destroyed in some way. The second point refers to the important role that the use of counterpart funds can play in effecting policies--in contrast to building physical capital items. Thus, counterpart funds can be used to induce productivity growth, to encourage greater labor intensity, help break supply bottlenecks, and to put in place other policies that add flexibility and responsiveness to the system.

The chapter concludes with a discussion of the difference between counterpart funds generated from commodity aid and those generated by cash transfers. In general the differences are minor.

Chapter 7 examines the actual uses of counterpart funds in 10 countries. These brief case studies illustrate the general arguments about counterpart funds developed in the preceeding chapter, but applies them in the context of specific countries.

> In Costa Rica there was an exceptionally imaginative use of counterpart funds that greatly facilitated the privatization of industries owned and operated by the government that had long been a major drain on government revenue. In Haiti the government has long been antagonistic to development, but the USAID mission there was able to find ways to use counterpart funds in a variety of humanitarian ways, more or less independent of the government, that were especially appealing. In both Costa Rica and Haiti, the particular objectives probably could not have been achieved had there not been counterpart funds.
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> In Tunisia several general lessons were illustrated, especially that the availability of counterpart funds provided A.I.D. with 'a seat at the table' where economic policy was being made. Having such a seat, it is argued, is a much more effective way for A.I.D. to wield influence than is conditionality or attempting to exercise leverage.
>
> In Madagascar the importance of isolating the specific constraint that needed to be pushed back at the moment was emphasized. In a number of instances, counterpart funds have been used to affect a constraint that was not, at that time, binding, and hence the expenditure did little to enable the economy to improve its performance.
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> In Pakistan, the planning process was such and the relationship between USAID personnel and the Planning Ministry was such that it seemed that there was no real need for counterpart funds. In this case simply attributing certain planned expenditures to counterpart funds was quite in order.
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> In Kenya there were unspent funds, and the reasons why and the consequences are explored.
>
> In Mozambique and the Dominican Republic the question of the use of counterpart funds to contribute to a stabilization policy versus their use as a means of affecting allocation is examined. In Jamaica monetary effects are studied to show that there is some confusion in the literature in the thinking about these matters.
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> Finally, Egypt is cited as a case where political considerations dominated aid decisions, and hence, it is argued, it is very difficult for the A.I.D. people to play a significant role in the determination of general development strategy and in the uses of the counterpart funds there. In this case it is argued that a preferable approach might be to allocate such funds--if possible--for non-governmental institutions.

In Chapter 8 there is a brief summary and a set of conclusions.

COUNTERPART FUNDS

Chapter I. Introduction

The primary objective of this paper is to survey and evaluate the literature on the impact of counterpart funds programming on development in aid-receiving countries.[1] Evaluation includes appraisal of the arguments and ideas actually worked out in the available literature and the identification and discussion of issues that we deem important that have not been examined, or have been examined inadequately in that literature. There are a variety of technical issues discussed in the counterpart fund literature. This review will discuss the consensus views on these issues, to the extent that a consensus exists, and attempt to clarify remaining conflicts. The empirical importance of the technical issues to the development impact of counterpart funds will be examined.

To achieve these objectives, we have sought to develop the full story of how counterpart funds work: how they are generated, the consequences of that generation on various key aspects of the economy, how they are used, and how their various uses affect the development of the aid-receiving country and the donor's basic objectives in providing the aid. The story we write is built around the existing literature, and by telling this full story, we both cover the literature and identify where it is incomplete and where it is misleading or simply wrong. In our story, we believe that we have corrected all the errors and misleading arguments and filled in all the lacunae. Our story, then, is our view of the state of knowledge of the counterpart fund approach to aid and development.

This approach may be contrasted with one that is primarily bibliographical, i.e. one where we would have summarized various authors and discussed their contributions more or less independently of other writers. This latter approach, however, would not provide a general picture of the counterpart fund approach, and therefore would not allow us to see clearly how the various parts fit together and so where the existing literature is incomplete. Also, most of the ways in which we found the existing literature misleading or wrong arose from the fact that the

[1]Historically, counterpart funds were a subset of local currency and referred to government owned local currency over which the donor had some control. The terms are now used interchangeably.

analysis was done in the absence of a full story of the counterpart process. This procedure means that something is often left out, something that in a more complete picture would turn out to be of great relevance, and often implies assumptions that are inconsistent with the more complete picture of the process. We did not find in the literature any effort at the full statement that we have undertaken to provide.

A short summary of our position, may help the reader. In many instances the counterpart fund approach associated with commodity and cash aid serves no useful purpose and can indeed create significant costs for both donor and recipient. It is important to recognize this and to be able to identify when this is in fact the case. It is, however, equally important to recognize that in several fairly general contexts, the counterpart fund approach offers numerous opportunities for making aid much more effective than it would otherwise be. This position has two important policy implications. In the first place it means that hard and fast rules that apply under all conditions in all countries are undesirable. The second implication is more demanding. For the counterpart funds to be effective -- to be worth their cost -- requires that the USAID people in the country have thorough knowledge not only of the way the aid receiving economy works but also of the institutional, political, and cultural aspects of the society in order to identify any ways in which counterpart funds could be exploited. The most convincing evidence that we have found to support the use of the counterpart fund approach is specific case studies where they have been used to great effect and where, it seemed to us, no alternative approach would have worked nearly so well. In our discussions we try to point up such cases as well as cases where, we concluded, the approach was essentially unnecessary.

One final point is important to our arguments. Aid in any form is intended to contribute to the development of the recipient country. Our understanding of the development process, and indeed of the objectives of development, is primitive indeed, and disagreement is expected and inevitable, and the specific characteristics of the individual country matter greatly. Recognizing this helps us to see clearly how important it is to allow flexibility and to stress the importance of people in the USAID missions having the freedom to search for effective ways to fit the needs of the specific country.

The paper is organized as follows. The following chapter, Chapter 2, reviews definitions, and covers a bit of history to give a perspective on the current state of counterpart fund arrangements. Chapter 3 discusses the data and provides some insight into how important, empirically, counterpart funds are in their several roles. Chapter 4 considers the arguments about whether counterpart funds add much to the effectiveness of the United States aid programs. Chapter 5 studies the various technical issues relating to counterpart funds that have attracted so much attention and are subject to considerable confusion. Chapter 6, in turn, tells several stories that illustrate the various technical issues as well as some of the more general ones. Then Chapter 7 examines counterpart fund experience in a number of countries to help gain greater understanding of their operation in the "real world." We then add, as Chapter 8, a brief summary and conclusions.

Chapter 2. Definitions and History

We begin with some definitions and a brief comment on the origins of the counterpart fund idea.

A. Definitions. Counterpart funds refer to the local (domestic) currency obtained from the sale of commodities or foreign exchange[2] received as aid by a government, from a donor country or international organization, and over whose use the donor has some control. The counterpart funds may be owned by the government or, less frequently, by the donor.[3] The term is limited to the sale of commodities and foreign exchange received as aid. A government may borrow foreign exchange in the commercial markets, sell it to the Central Bank for local (domestic) currency, and use the local currency for whatever it chooses. Local currency obtained in this way is not counterpart funds. Similarly, exporters may receive foreign exchange for their sales abroad and sell it to their bank for local currency, but this local currency is not counterpart funds. Tourists sell foreign exchange for local currency, but such transactions do not result in the creation of counterpart funds. Foreign investors who need the currency of the country in which they are investing buy it with foreign exchange, but the local currency thus obtained is not counterpart funds. These examples clarify the peculiar aspects of the counterpart fund phenomenon and demonstrate that the creation of such funds is similar to other activities that are taking place in the market that have nothing to do with counterpart funds.

Generating counterpart funds is similar to a government borrowing abroad in commercial markets, but there is a difference. A government borrows the foreign exchange, sells it, and has local currency just as in the case when counterpart funds are generated by aid. Now the government has an obligation to repay, and the lender, in return for that obligation, exercises no control over the use of local currency generated by the government. In the case of an aid grant, there is no repayment required, but the recipient government agrees to allow the donor some control (possibly even ownership of) the local currency as a condition for the grant. If the aid

[2]Foreign exchange aid can take the form of grants or soft loans.

[3]The local currency obtained by US private voluntary organizations from the sale of Title II commodities is not counterpart funds, since the aid was not given to the government.

takes the form of a long term loan at low interest rates, then repayment is necessary, but the recipient allows the donor some control in return for the softness of the loan. Thus the exercise of some control by the donor and the fact that local currency is not generated in the productive process are the key features of the counterpart fund process that distinguish it from other similar phenomena. Recipient countries have questioned the justification for any influence on the use of the counterpart funds by the donor in several instances, as will be discussed in the case studies in Chapter 7.

Note that counterpart funds are not the local currency costs of donor financed projects, although governments can and do use counterpart funds to cover such costs. Similarly, counterpart funds are not the recipient country's share of the cost of a donor financed project.

Complications often arise in pricing the aid commodities in the recipient's market or in determining the appropriate exchange rate in the case of cash transfers. The issue is especially clear in the case of aid commodities that are to be sold in the market of the recipient country. The price in this market may well differ from the price (or cost) attached to the aid commodities by the donor or the price of the commodities in world markets. The amount of aid given will then be different from the amount of aid received. In the case where the market price is less than the donor cost, the donor may insist (for reasons to be examined) that the recipient allocate more counterpart funds than those received from the sale of the aid commodities. Sometimes, recipient country market price exceeds donor cost (e.g. rice in Ghana) so counterpart funds generated exceed donor costs. This difference between market receipts and counterpart funds may complicate the task of insuring that the commodities and the funds have the intended impact on the economy. Disagreement on the value of aid commodities can involve the exchange rate, the price in the recipient country, the price or cost in the donor country, and/or world market prices. The donor may, for example, think in terms of providing so much aid in its own currency. In this case the price at which the aid commodities are sold in the recipient's market must be converted into the donor's currency at some exchange rate. Evidently the choice of rate can make a difference as to whether the dollar amount is acceptable. In this example, the amount of aid that the donor believes it is giving in its own currency is presumably based on the donor's estimate of the value of the aid commodity. This must be based on prices in the donor country or in world markets. There is much room for disagreement between donor and recipient on the appropriate price, as well as exchange rate.

In the case of a cash transfer, the corresponding question becomes unambiguously which exchange rate is to be used. If one exchange rate is used to convert the cash aid to local currency, but another is used in most of the foreign trade transactions, then again the process is made more complex because the counterpart funds differ from the value of the commodities that have been made available by the aid. Also the donor may argue that less counterpart funds resulted from the cash transfer than was justified by the quantity of aid. In more recent years there do not seem to have been major problems on these matters, although discussions of the effects of an overvalued exchange rate on counterpart funds generated have arisen relatively frequently in the 1980s.

Counterpart funds are created by the aid provided by the foreign donor, but are in the currency of the recipient. Who then should own the funds? This question has no unambiguous, analytical answer, and has often created considerable friction. If, for example, the donor owns the funds and uses some of them to satisfy its own demands for local currency in the recipient country, then the amount of aid is, of course, less than the transfer of the real resources. If the donor owns them, but uses them on behalf of and with the approval of the recipient country, then the issue is whether there is any extra role of ownership as such, as opposed to the right to agree or not agree on their uses. Here the arguments are less clear cut. In the 1940s, 1950s and 1960s, the US most often owned them, but starting in the 1970s, the recipient has usually had legal ownership, but the donor has some role in the determination of what they are used for and when they are used. Ownership is relevant in several ways, which we will discuss, but in general it does not seem to be especially important to the major analytical issues discussed in the following sections. The point now is simply to note that ownership adds both administrative and substantive complexity to the role that counterpart funds can and should play in development.

To summarize: counterpart funds are created by the sale of commodities or foreign exchange received as foreign aid by the recipient country government. How much counterpart is created depends immediately upon the price of the commodities in the market of the recipient and on the exchange rate used to convert the foreign exchange aid to local currency. But these prices may be subject to dispute between donor and recipient and hence to some sort of compromise that could result in the amount of counterpart funds created differing from the values that take place in the market. Disputes also arise over ownership and control. Since different donors may insist on different practices, a recipient country may have considerable difficulties -- and use considerable resources managing such funds and sorting out their impact on its economy.

B. History. A brief history of counterpart funds helps to make clear the perspective that we bring to the argument. Large scale foreign aid is a post-World War II phenomenon; so then are counterpart funds. Foreign aid to the European countries during and immediately after the war first brought attention to counterpart funds. Lachman (1968) describes the aid to Italy in the late 1940s as an early example of the notion of counterpart funds and its application. It was, however, with the Marshall Plan that the counterpart fund idea became widely known and the issues associated with it began to occupy widespread attention.

Although available documentation is not completely clear, it seems that the principal rationale for the counterpart funds was as an instrument of stabilization policy, an instrument to help bring and keep expected inflation under control. (See discussion by Riefler in Lachman (1968), and in Berenson, et al. (1958)). The general idea seems to have been that the large scale investment that the Marshall Plan made possible in the war- damaged countries would tend to produce significant inflationary pressures and, that the counterpart fund procedures could help relieve these pressures. The inflationary pressures were expected to emerge from the investment, and that investment would, in turn, induce greatly increased consumption expenditures. All this would take place in economies where the supply response was expected to be slow and weak in appearing. The current account deficit made possible by the Marshall Plan was, presumably, not believed to be adequate to prevent the inflation.

While the argument that the withdrawal of counterpart funds from the market could dampen inflation pressures is an acceptable argument, it is much less clear why the process was deemed necessary. Certainly instruments were already available to the European countries that could effectively combat inflation, without relying on the use of counterpart funds. Could they not have engaged in open market operations, tax policies, etc. in such a way as to prevent the inflation? The governments of Western Europe had informed and effective civil servants, their capacity to design and implement monetary and fiscal policies was well established, and they needed little advice from the United States. Indeed, a number of people in Congress and in the Executive branch argued strongly against United States ownership of the counterpart funds because it would mean that responsibility for European stability would appear to fall heavily on the United States.

Why then have counterpart funds? One argument may be put as follows: The governments of the European countries recognized that the making and implementing of policy, especially anti-inflation policy, was extremely difficult politically. Demand had been restricted during the war and there were strong pressures to spend. Therefore, having something like the counterpart funds arrangement that committed the governments and that limited what they could do in rather firm ways seemed acceptable, even desirable in the immediate postwar years. In this case, the recipient countries may have deemed some tying of hands, some limitation on freedom as useful. This argument will enter our analysis later.

There were some conflicts and disputes in the implementation of the Marshall Plan, but it is widely accepted that, for a program of its size and complexity, it was remarkably free of friction and dispute. There are references in the literature about some conflict over ownership and control of the counterpart funds; Great Britain, for example, simply did not use counterpart funds in order to avoid having the United States exercise any influence over their use (Towsley, (1976)). Also, apparently there was some unwanted pressure in some countries from the United States to put arms development (as an anti-communist policy) ahead of the use of the funds to help control inflation. In general, however, the whole process worked well.

After the successful completion of the Marshall Plan, foreign aid began to be concentrated on the developing countries. In the 1950s, food aid was perhaps the major form of aid and it had significant effects on how the United States thought of its other aid programs. While foreign aid to developing countries had strong enemies from its very beginning, no one opposed the reduction of the agricultural surpluses created by US farm policies. So aid in the form of surplus food products found much more support than did other forms of foreign aid. The counterpart fund idea tended to make it even easier for members of Congress to support food aid, because it appeared to many that the United States was in fact exercising some additional influence on general economic policy of these countries. Some, although apparently not many members of Congress also seemed to believe that the counterpart fund idea was a way of inducing the receiving country to pay for the food imports. This misunderstanding is often noted in the literature as a widely held view, but we have found little overt argument that actually asserts it.

Arguments for counterpart funds and donor influence over their use were more convincing for developing countries than for European countries. Food was of course a consumption good, and as such served important and evident humanitarian objectives. At the same time, donor and recipient acknowledged that a longer run objective was to enable the developing country to be able to feed itself. This objective required increased productivity of its domestic resources. So then if the food aid generated counterpart funds and these funds were in turn used to enhance the productivity of the domestic resources, the recipient could make headway in becoming independent of foreign aid in the future. Again one should ask however, why it was deemed necessary to go through the counterpart fund routine to achieve this objective?

There are several different parts to the answer. From the standpoint of the recipient country, counterpart funds associated with foreign aid could be extremely useful. These economies were characterized by large subsistence sectors, incomplete markets, and weak trading sectors. This made taxing difficult, and the low incomes resulted in very low rates of private saving. Similarly, the tax bureaucracy was inexperienced and ill-paid, so tax collections of all kinds were difficult. It was especially difficult to tax windfall gains, inflation gains, and capital gains (especially on land). For the government to obtain local currency funds by borrowing from the Central Bank was to ask for inflation and, indeed, some governments were, in principal, opposed to such borrowing. In this sort of environment, it was almost as difficult for the government to obtain local currency as it was to get foreign exchange. Yet the government needed local currency -- command over domestic resources -- to achieve its longer run, development objectives. Counterpart funds helped meet this difficulty. While the fact that the donor would have some control over the use of the funds was often resented, there was, in the 1950s, greater acceptance of the idea that foreign consultants and advisors from rich countries might know more about development than did the civil servants in the developing countries (Singer et al., (1987)).

From the standpoint of the donors, especially the United States, the counterpart fund procedure also seemed reasonable. The provision of food aid meant that the donor supplied a consumer good that met, or could meet, a genuine human need, while the counterpart funds meant that, in so doing, resources were made available to help the country become independent of aid. Since the provision of the food aid had notable advantages to the United States, the whole package made the idea of foreign aid go down a bit more smoothly. The fact that the donor had some influence over the use of the counterpart funds also was thought to ensure that they would in fact be used productively. These arguments are relevant because counterpart funds are in some ways an illusion. Several people have indeed so argued, and we will examine that argument in detail in the following section. Our main point here is to recognize that in a particular historical and institutional context, real and important arguments may support the use of counterpart funds.

In the 1950s, two problems relating to counterpart funds appeared more or less immediately. Schultz (1960) and others noted that the pricing or valuing of surplus food commodities was open to all kinds of difficulties. The cost of such commodities to the United States agency handling the actual transactions was very much larger than the calculated value of these commodities to the recipient countries. Schultz's estimates for the 1950s suggest that the value to recipients was only a bit more than one third of the former. This difference created difficulties between donor and recipient: it seemed to the donor that it gave so much, while to the recipient it received so little.

The second problem that surfaced in the 1950s refers to the extent to which counterpart funds could substitute for foreign exchange. Those members of Congress and others who were less than enthusiastic about aid in general pushed the argument that counterpart funds could in fact substitute for foreign exchange. The recipient countries strongly resisted this view. They argued that the counterpart funds did not replace the need for continuing injections of foreign aid, in the form of commodities or cash. (Sen, (1960)). This issue became increasingly important as unspent counterpart funds accumulated (in some countries) to enormous amounts. An influential paper by Edward S. Mason (Atlantic 1960) drew attention to the fact that the United States had access to large foreign currency deposits in countries around the world. Mason makes clear that such funds do not constitute additional real resources, but many in Congress and elsewhere could ask again: Why, if there are huge sums of unspent counterpart funds, is it necessary to appropriate more dollars?

This last question, we emphasize, is not a nonsense question, and brings us to the last item in this introductory section. This item refers to our understanding of how development takes place, and how we can help it take place. In large part, many of the problems that have appeared with respect to counterpart funds -- the rationale of their creation, their impact on the economy, their specific uses, the extent to which they can substitute for foreign exchange or commodity imports, etc -- arise because our understanding of how development can be induced in specific historical contexts is inadequate. In the following sections we will frequently emphasize this point.

If the basic long run objective of foreign aid -- as distinct from short run humanitarian and stabilization considerations -- is to make aid unnecessary, then the ultimate criterion is the extent to which the counterpart fund process contributes to that objective in the most effective way, and this depends on our understanding of the development process. This point affects how a donor should think about its influence over the use of counterpart funds (or aid in general) as a source of leverage; that is, as a means of getting the recipient government to do something that it, in some sense, does not want to do. When one speaks of a donor's leverage, one implies that a donor knows something that the recipient does not know or does not accept. The donor knows best. The literature that we have examined suggests that the efforts to use donor control over counterpart funds as a source of leverage has led to many problems between donor and recipient.

At the same time one of the most frequently cited arguments for counterpart funds is that they do give the donor an additional source of leverage. We believe instead that counterpart funds are useful when they allow recipients to do something that they would not be able to do otherwise and that something is also valued by the donor.

The final general point that is relevant here, and in other contexts, has to do with the objectives of development. That this is a source of difficulties in many instances seems clear, although there is very little direct discussion of it in the literature. Donors often place great emphasis on objectives that recipients give -- at best -- lip service to, or even oppose. Disagreement on the use of counterpart funds may be traced to a difference of views as to what the long run and immediate objectives of development are or should be. Objectives such as the role of women, the distribution of income and assets, population control, environmental improvement are issues on which donor and recipient can easily disagree. The point here is to note that in discussions of policies and projects, a clear distinction between objectives and instruments is extremely important. Both lend themselves to disagreement, but the former is clearly the most delicate. This argument does not mean that the donor should not try to influence objectives in its discussions on the use of counterpart funds, but it does mean that it is important to get clear a specific statement on objectives.

The subject matter of this paper is the role of counterpart funds in development and the role of donors (especially the United States) in influencing the impact that counterpart funds can have. We are not concerned with the impact of commodity aid imports as such -- e.g. food -- financed by foreign aid, nor are we concerned with the problems of the management and monitoring of the counterpart funds. Both of these are important issues, but they are beyond the scope of the present study. Some authors feel reluctant to discuss separately the issues of the impact of commodity aid imports and the effects of counterpart funds. We believe that many of the issues relating to commodity aid imports are independent of the generation of counterpart funds: they would remain important topics and unchanged even if counterpart funds were not generated or programmed. When this is the case, we consider the issue beyond the scope of this paper. Similarly , most of the issues we discuss relating to counterpart funds are independent of the type of foreign aid -- commodity aid or cash transfers -- that generated the counterpart funds.

Chapter 3. The Data

Ideally, we would like to have data on total counterpart funds generated by all foreign aid sources over time, as well as data on how the counterpart funds are programmed each year. This would allow us to judge the importance of counterpart funds, for example, relative to total government spending or relative to the total money supply. Such data would allow us to start to answer such questions as "Should we worry about the monetary effects of counterpart funds?", "Are counterpart funds an important source of government revenue?", and "Do counterpart funds contribute to improved resource allocation?" Of course, such data would not definitively answer these or other questions relating to counterpart funds. In some cases, the data would in fact be of little help. In others, however, they would contribute to identifying and clarifying which issues are of greatest importance.

The existing data on counterpart funds are far from complete. AID reports the level of counterpart funds generated by its programs. The IMF, in International Financial Statistics, reports counterpart funds in the monetary survey for some countries. Data on the use of counterpart funds generated by USAID are reported in country studies, but are not published consistently in one place in any systematic way. We have found no data on counterpart funds generated by other countries' aid programs. The data sources that we have found are discussed in more detail here.

AID generates counterpart funds through its commodity aid and cash transfer programs. There are relatively complete data on the levels of counterpart funds generated by AID. AID publishes a document every quarter entitled "Status of Foreign Currency Funds administered by the Agency for International Development". (This document has been published since 1961.) It reports data on foreign currencies (in both foreign currency and U.S. dollar equivalents) "for which AID is accountable, either owned by the United States or otherwise controlled through requirement of A.I.D. approval for dispersement." It reports the following data:

- outstanding balances of U.S. owned and recipient government owned counterpart funds by generating program, in U.S. dollar equivalents.

- outstanding balances, deposits, and disbursements by country and by generating program, during the fiscal year to date in foreign currency units and dollar equivalents.

Within AID, there is some concern about the completeness of these data, in particular that these data substantially understate the amount of counterpart funds generated and outstanding. Below, sensitivity of conclusions to problems with the data will be discussed.

To get a sense of the importance of counterpart funds generated by USAID in individual recipient countries, Table 1 shows the unexpended balances as of September 1987 and 1988, and the deposits and disbursements made during the fiscal year for six major AID aid recipients. These data will be discussed in greater detail below.

The IMF, in its International Financial Statistics, also reports counterpart funds. Counterpart funds deposits in the Central Bank are reported in line 16e ("A Guide to Money and Banking Statistics in IFS," IMF, 1984, pp. 481-484). These include U.S. owned and government owned. Counterpart funds are a liability of the Central Bank, and enter in the accounts in the same way that government deposits and foreign liabilities enter. Line 26e reports counterpart funds held in commercial banks and line 36e is the sum of 16e and 26e, equal to the total counterpart funds held in the banking system. In the IFS data, eleven countries have data on lines 16e, 26e, and 36e. The available data for these countries and years are shown in Table 3.

Data on the use of all counterpart funds are not collected and published in any systematic fashion. Use of U.S.-owned counterpart funds generated under the PL480 Title I program, is reported in "Food for Peace", Annual Report in Public Law 480, Department of Agriculture (see Annual Report 1979, Table 14, Annual Report 1987, Table 14, p.47).

Data on the use of recipient government-owned counterpart funds are not collected and published systematically. Information on the use of USAID joint programmed counterpart funds can be obtained from a variety of sources. USAID Document (AID 370-3 (8-83)), discusses the uses of ESF generated local currency. Country studies of the aid programs that generate counterpart funds almost always discuss the use of counterpart funds. Actual year to year data on the allocation of counterpart funds are, however, not available in any one published source.

A question of interest is whether systematic data on the allocation of government owned counterpart funds would mean much. For joint programming of counterpart funds to have any independent effect on the country, the allocation of resources within the country must be different from what it would have been had there been no counterpart funds available. This means one must have knowledge about what the allocation would have looked like without the joint programming, which is not something that we can easily determine.

In many countries, joint programming consists of USAID agreeing to a "for attribution" procedure. What this means is that the government presents USAID with a set of expenditures, already included in the government budget[4], that it would like to pay for with the counterpart funds. USAID then gives its "stamp of approval" to the whole list or some subset. In this case, it seems clear the joint programming of counterpart funds is having little to no direct effect on resource allocation. If USAID says "no" to one item, but an acceptable alternative budgeted item is found, government revenue is almost 100% fungible. Examples of countries where counterpart funds are programmed in this way include Pakistan and Mozambique.[5] Note that in cases of budget attribution, USAID may well have considerable effect on the country's development program as a consequence of its presence and its general role as a donor -- in contrast to the role arising out of its right to approve or disapprove specific expenditures of counterpart funds.

In countries where counterpart funds are not programmed this way, the issue of what the allocation of resources would have looked like without the joint programming still arises. Data on the allocation of counterpart funds would not necessarily allow one to determine this. A case study of an individual country's circumstances along with the data on joint programming might allow one to determine the effects on resource allocation. It might be possible to conclude that certain expenditure took place that would not have otherwise. But the point is that extensive knowledge of the country, along with the data on the use of counterpart funds, would be needed to reach this kind of conclusion.

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[4]These items most often, but not always, come from the government development budget.

[5]Of the six or seven major recipients of U.S. aid, it would be of interest to know how many program counterpart funds this way.

Chapter 4. The Debate Regarding Counterpart Funds

There are a variety of technical issues on which there is general consensus in the literature, although often some confusion. These issues are discussed in the following chapter, Chapter 5. The larger and more important debate surrounding counterpart funds relates to whether or not the whole process of generating and programming counterpart funds is a useful undertaking. Opinions on this issue range from strong support for viewing counterpart funds in addition to the foreign exchange or commodity aid as an effective development tool to equally strong support for eliminating the use of counterpart funds all together. We believe that these views are not as mutually exclusive as the literature implies, as each position may be appropriate for some countries at some points in time. This means that there is no one correct view of the benefits of the counterpart funds process, and that only one position on counterpart funds therefore may be inappropriate.[6] This section will survey these various views. Chapter 6 will discuss several general examples of country circumstances under which different views about the benefits of counterpart funds will hold true. Chapter 7 will discuss actual country examples that demonstrate these arguments.

The argument that supports aid combined with active donor involvement in counterpart fund allocation, is really identical to arguments for supplying aid on a project basis. The donor must believe that the net benefits (presumably to the developing country)[7] of the transfer are higher with donor control over allocation of the transfer and that the existence of counterpart

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[6]This argument implies that discretion dominates rules, an issue of considerable debate in the general economics literature. This issue has not entered the debate in the literature on counterpart funds, but we refer to it in several places.

[7]There seems to be some ambiguity about AID objectives of programming counterpart funds. Poulin (1988) states that they should be used "in a way that improves the overall allocation of host government resources for development purposes." At other times in other AID documents, the objective of programming counterpart funds is stated to be "maximizing achievement of AID mission objectives." It is not clear that the two sets of objectives need always totally coincide. For example, counterpart funds are often allocated to the local costs of AID projects. Given spending constraints, should these be funded? Doing so could contribute to AID objectives but not necessarily country development objectives. In a similar fashion, the use of PL 480, Title 1, Section 108 program funds "may not be used to promote the production of agricultural commodities or the products thereof that will compete, as determined by the President, in world markets with similar agricultural commodities or the products there of produced in the United States." This suggests that AID maximizes its objectives subject to constraints.

funds contributes to control over allocation decisions. The reasons for believing the former can vary, from concerns about the objectives of a given government, to concerns about the ability of a given government to achieve its objectives in the face of political constraints. A particular government in a recipient country at a particular point in time may not have as a primary objective the development of a country. Any additional resources made available to such recipient government would be allocated to other goals, such as increasing the military or buying-off particular interest groups. In such a situation, additional resources made available with strings attached may contribute to development at the margin. (An obvious concern is that any development expenditure that the government would have undertaken may then be reduced dollar for dollar!)

Alternatively, a government at a particular time may have development objectives but be constrained by political problems. Tied aid could be useful in allowing the government to pursue these desired, but politically difficult, objectives.

Note that the role seen for counterpart funds in these examples is as a means of controlling the allocation of the aid transfer. The counterpart funds are not resources additional to the commodities or foreign exchange, the real resource transfer of aid. They do however provide a mechanism for USAID to exercise some control over the allocation of local currency resources the government gains as a consequence of the aid. Supporters of counterpart funds must believe that programming counterpart funds does help to influence the allocation of resources. Poulin (July 10, 1988 p. 5.) states that AID policy is that if it is possible for AID missions to "influence their [counterpart funds] use in a way that improves the overall allocation of host government resources for development purposes, they should do so."

Similarly, there are those who believe counterpart funds can contribute to development at particular times in particular countries because the process transfers resources to the government. Many developing country governments may not have the resources to undertake valuable development expenditures: tax systems may be weak for a variety of reasons; borrowing from the private sector may be limited by the low savings rates of the private sector; and borrowing from the Central Bank may also be limited, for example by host country concerns about inflation or by

IMF conditionality. Although a government can always technically increase resources at its command, in practice there may be many constraints on its doing so. When it is not able to increase resources on its own account, aid in the form of commodities or foreign exchange, combined with counterpart funds would relax this resource constraint (Singer, et al. (1987)). Whether these additional resources relax the development constraint, however, depends on how they are used. Those who believe in joint programming of counterpart funds believe that donor input will contribute to net benefits. If the sole benefits arose from greater resources available to the government, the aid transaction without the counterpart funds would be sufficient. The government could use the aid resources to obtain local currency, but this local currency would not fit the technical definition of counterpart funds without the donor control.

Others believe that counterpart funds could contribute to development by getting resources to the private sector, rather than the government. An amendment to PL 480 legislation in the Food Security Act of 1985, called the Local Currency Loan Initiative, was intended to encourage private enterprise. Local currency obtained from sales of food aid commodities under section 108 are loaned to private sector firms to encourage growth. The funds are channelled to private sector firms through intermediate financial institutions. This initiative was designed to shift resources made available by the sale of Title I food aid from the government to the private sector. This reflects a belief that on the margin, greater development will be facilitated from a shift in allocation toward the private sector, rather than toward the government. Section 108 loan programs are too new to know whether they have had a positive developmental impact.

On the other hand, some people argue that no type of aid should be tied, while others argue that tying the aid can take place without the use of counterpart funds. Either view would support the elimination of generating and jointly programming counterpart funds. Belief in "untied aid" would leave no role for counterpart funds. Alternatively, other opponents of counterpart funds argue that the influence on policy comes from the transfer of real resources. If the policies or projects agreed to are not carried out, then future transfers can be curtailed. The existence of the counterpart funds in no way adds to the size of the stick or the carrot: They argue that counterpart funds do not increase donor control over the allocation of resources in the recipient country (Towsley, (1978)). The UK, during the Marshall Plan, is often cited in support of this position. The UK objected to US control over its policies. The British government therefore left the counterpart funds generated by Marshall Plan aid unspent and instead increased borrowing from the Central Bank to fund expenditures.

John P. Lewis (1962) discusses this argument against counterpart funds in the context of India. He initially felt that the Indian government's objections to counterpart funds resulted, not from their potentially inflationary effects, but from "antipathy to the degree of joint control with India over some wholly indigenous development projects that the scheme seemed to give the U.S. aid authorities" (Lewis, (1962), p. 320). Lewis rejected this argument, however, for several reasons. The first was that the counterpart funds need not imply control, as in the above UK example. The recipient country can choose to leave the counterpart funds idle, and instead borrow an equivalent amount from its Central Bank. Secondly, India discovered that it could present the U.S. with a list of projects from the budget, that would have been carried out anyway, that met U.S. requirements. With these two options, U.S. control over counterpart funds has little or no effect on allocation.

Little and Clifford (1965) discuss this case.

> But, where a country has proper banking institutions, it does not need to borrow or be given, with strings, its own currency from the USA. It can borrow it from its own banking system. It makes not the slightest difference from the economic point of view what it does. Therefore, such a country will use these counterpart funds only for the things it wants to do anyway, and only then in order to please the Americans. This is why so much remains unspent. In fact, the control is largely a sham, and in any case AID administrators, conscious of the absurdity, do not exercise the same degree of surveillance, even in countries where such surveillance might be beneficial, as they do over new aid funds. (Little, Clifford, (1965), p. 173)

Little and Clifford argue that there are no benefits from the generation of counterpart funds and many costs. counterpart funds can, they argue, increase misunderstandings between donors and recipients, waste administrative effort, and can complicate "sound budgeting and planning" by generating some domestic funds that can only be used under special arrangements.

Additionally, there are those who believe that aid associated with counterpart funds can have development benefits, but that counterpart funds involve costs that can easily outweigh the benefits. These costs could include creating ill-will between the donor and recipient or actual personnel costs for either the donor or recipient of monitoring the counterpart funds. Ill-will could arise either because of the control on allocation, although this would be true of all tied aid independent of counterpart funds, or because counterpart funds control involves intrusions by donors into accounts that are particularly sensitive to recipients. Another cost of counterpart funds mentioned in the literature (Towsley, (1976)) is the possibility that the existence of counterpart funds will be misunderstood by the U.S. Congress and result in less new real resource transfers to developing countries. Although the management costs of counterpart funds are the subject of another study, they are important to mention here. Lewis ((1962), p. 323), in the context of India, mentions that the U.S. procedures for allocating counterpart funds created costs in terms of accounting and paper work, which may explain India's choice to avoid the use of counterpart funds.

A closely related argument against the use of counterpart funds is that although there are potential net benefits of programming counterpart funds, the USAID missions responsible do not have the staff or time to provide good advice. This is different from saying the management costs outweigh any benefits, in which case counterpart funds are not useful under any circumstances. Instead potential net benefits from programming counterpart funds cannot be realized if the necessary inputs, in terms of USAID personnel time and expertise, are not available. Given severe management constraints on USAID missions, it would be better not to program counterpart funds. But, USAID might want to reallocate available inputs in situations where potential net benefits from counterpart funds appear significant. In some countries, use of real resources to increase USAID management inputs might in fact be more valuable then greater aid without the additional USAID management inputs.

Another case against counterpart funds hinges on the difficulties of knowing whether host country resource allocation has been affected. To know whether programming counterpart funds has affected resource allocation one would need to know what it would have looked like without the counterpart funds. Although it may be difficult to confirm that additional resources have been allocated to some general sector, it seems clear that in some instances one could confirm that specific government expenditures took place with counterpart funds that otherwise would not have. (For example, if a particular project or some spending category gets protected from across the board cuts because of counterpart funds, then clearly resource allocation has been affected.)

Intermediate positions are also found in the literature. Clement argues that counterpart funds should be "untied" in countries with International Monetary Fund and World Bank programs. The donor need not control the allocation of budgetary resources, since "these programs include a sound public investment program and a close monitoring of government expenditure. Thus, the donors should be reassured that with counterpart funds fully integrated in the design of macroeconomic policies these funds, like any other budgetary resource, will finance sound appropriate government expenditure." (Clement, (1989).) The argument is therefore that an adequate degree of influence on the allocation of resources should be exercised by the Bank and the Fund on the total budget, and not by the donor. Certainly there is a case for coordination. Differences in opinion on the appropriate types of projects to be financed can be accommodated. Differences in opinion on policies, such as monetary goals or borrowing, ought to be worked out between donors and international organizations before advice is offered or conditionality imposed. USAID faces a statutory requirement that its resources aim to improve the lot of the poor majority. Given the Fund's reluctance to address income distribution issues, there is a problem of USAID delegating all policy influence to the Fund. The Kemp-Kasten Amendment (1984) prohibited direct USAID linkage to World Bank and IMF programs. This prohibition has since been repealed.

Many of these views on counterpart funds are not mutually exclusive. Each view may be correct in some country at some time. We will attempt to clarify in Chapters 6 and 7 how different country circumstances determine the effects that aid and counterpart funds can have on development.

Chapter 5. Technical Issues Relating to Counterpart Funds

There are a variety of issues relating to aid and counterpart funds about which there is generally a consensus in the literature, although still a bit of confusion. These issues include:

1. the effects on the money supply,
2. the effects on the balance of payments,
3. the effects on government finances,
4. the effects on inflation,
5. whether counterpart funds represent additional real resources beyond those of the actual aid,
6. the effects on the exchange rate,
7. the problems of large balance countries,
8. who should own the counterpart funds,
9. how much local currency should be generated for each dollar of aid (be it foreign exchange or commodity aid).

On each of these issues, we will present our view of the consensus position and discuss any confusion in the literature. In addition, we will discuss the relationship between each issue and the development impact of counterpart funds. Some of the issues seem to have received undue attention in the literature.

1. The Effects on the Money Supply

The effects of aid and counterpart funds on the money supply are discussed at great length in the literature. The impact of generating and spending the counterpart funds on the money supply have been worked out in detail (Roemer, (1989), Clement, (1989), J.P. Lewis, (1962), p. 315). In this section, we will discuss the immediate impact effects of counterpart funds. What we mean by impact effects is the partial equilibrium effects -- the effects assuming that all else remains constant. But, of course, it is likely that all else will not remain constant. In particular, in a country with a fixed or less than a freely floating exchange rate, the change in the money supply depends on both the government and balance of payments deficits. In turn, foreign aid and counterpart funds usually affect both the government budget and the balance of payments. Therefore, the general equilibrium effects of aid and counterpart funds will almost always be different from the impact effects. Nonetheless, the impact effects are a link in the chain of events and are important to have clear. These effects will be discussed here, and the effects including any changes in the government budget and balance of payments will be discussed in detail below. Some of the confusion in the literature on the monetary effects of counterpart funds stems from being unclear about exactly what is assumed constant and unchanged.

Assume a donor supplies foreign aid in the form of commodities. The recipient government then sells the commodities to the private sector. This transaction transfers domestic currency or commercial bank deposits from the private sector to the government. The easiest way to track the effects of aid and counterpart funds on the money supply is to write out the Central Bank balance sheet.

Simplified Central Bank Balance Sheet

Assets	Liabilities
1. Net foreign assets (NFA)	3. Currency
A. (+) foreign assets	A. cash in vaults
B. (-) foreign liabilities	B. currency in hands of the public (CP)
2. Central Bank Credit (CBC)	4. Commercial bank deposits at the Central Bank
A. to the government	
A.a. (+) loans to the government	
A.b.1. (-) government deposits	
A.b.2. (-) counterpart funds	
B. to the private sector	

Setting assets equal to liabilities yields:

$$NFA + CBC = CP + RE = H$$

where $RE = 3A + 4$ = reserves of the banking system

H = reserve money (high powered money, the monetary base)

In the simplest version, when the government sells the commodities to the private sector, private sector commercial bank deposits or currency holdings decline, while government deposits at the Central Bank, in the form of counterpart funds, increase by an equal amount. It is assumed here that the government deposits the money at the Central Bank. The effects of this transaction are similar to a contractionary open market operation. Reserves of the banking system decline as a result. As with an open market operation, the precise effect on the money supply depends on the relationship between reserves (high powered money, monetary base) and the money supply

(M). The counterpart funds transaction reduces the reserves of the banking system, which reduces the money supply by some multiple, depending on the money multiplier. The money multiplier, which depends on among other things, the reserve requirement and on any excess reserves held, need not stay constant. As a first approximation, however, $\Delta M = u \cdot \Delta H$, where u is the money multiplier.

The effects of generating counterpart funds are marginally more confusing if the government holds the counterpart funds in the commercial banking system or if the donor owns the counterpart funds. If the government holds the counterpart funds in a commercial bank, the government deposit is not included in the money supply by IMF definition, (IMF (1981); "Government deposits are not included in either money or quasi-money, particularly because they do not represent liquidity in the sense that they do not constrain government expenditure policies and are thus different in character from private sector deposits", Roemer (1989), p. 43). If held in the commercial banks, however, the contractionary effects on the money supply are smaller than if held in the Central Bank. This is because in the former case, reserves are not withdrawn from the commercial banking system. (If the reserve requirement against government deposits were 100%, then the effects on money would be the same as if the counterpart funds were deposited in the Central Bank.)

If the donor owns the counterpart funds and holds them in the recipient Central Bank in a special account, the monetary effects are the same as if the government owned them. Rather than government deposits at the Central Bank increasing, foreign liabilities would rise. Currency and deposits in the hands of the private sector decline. If the donor holds the counterpart funds in commercial banks, the effect on reserves is the same as when the government holds the deposits in the commercial bank. The effects on the money supply depend on whether foreign government deposits in commercial banks are included in the money supply.

If the aid is in the form of foreign exchange rather than commodities, the initial or impact effect on the money supply depends on whether the government sells the foreign exchange to the Central Bank or the private sector. If it sells the foreign exchange to the Central Bank, foreign assets in the Central Bank's balance sheet would increase and government deposits in the Central

Bank (the counterpart funds) would increase by an equal amount. The foreign assets are a credit while the counterpart funds are a liability of the Central Bank, owed to the government, of an equal amount. The monetary base (high powered money, reserves) therefore remains unchanged. The government would be using the aid to increase international reserves in this case.

If the government sells the foreign exchange to the private sector, the sale reduces currency or commercial bank deposits in the hands of the private sector, reducing the money supply. The effects of the sale of the foreign exchange to the private sector on the Central Bank's balance sheet are equivalent to the effects of the sale of commodity aid to the private sector.

There appears to be consensus on all these matters. In addition, it is generally agreed that if the counterpart funds are spent by the government or donor, the effects on the Central Bank balance sheet and the money supply are reversed. When the government spends the counterpart funds, the government's deposits at the Central Bank decline, the private sector's holdings of currency or commercial bank deposits increase, and the money supply increases. Therefore, if counterpart funds are generated by selling commodities or foreign exchange to the private sector, and the counterpart funds are spent right away, there will be no effect on the money supply, all else constant.

Are the monetary effects of counterpart funds important? They are in that control over the money supply is a government objective. The generating and programming of counterpart funds can either complicate or facilitate monetary policy, and therefore understanding their monetary effect is important.

The monetary effects of counterpart funds are more important, the larger they are relative to the total monetary base or money supply. In Table 2, various measures of counterpart funds from AID data are shown as percentages of reserve money during the fiscal year. Such percentages give an indication of the importance of the counterpart funds for the money supply. If all the counterpart funds on deposit in the Central Bank "unexpended balances" were spent, reserve money would increase by that amount. The money supply would increase by $\Delta M/M = u$ •

(CF/M) where u is the money multiplier, assuming u remains constant.[8] CF/M therefore gives an indication of the potential expansionary effect of counterpart funds on the money supply. The actual contribution of counterpart funds to changes in the money supply (ignoring any effects on the government budget or the balance of payments, which is discussed below) depends on the change in counterpart funds on deposit at the Central Bank. Increases in counterpart funds or deposits act to reduce reserve money, while spending counterpart funds (disbursements) and thus drawing down deposits at the Central Bank increase reserve money. The net effect is given therefore by the change in counterpart funds on deposit at the Central Bank, ΔCF, "deposits minus disbursements." Of the countries included in Table 2, counterpart funds were most important in the Sudan, where deposits of counterpart funds reduced reserve money by 5.2%. Taking into account disbursements, the generating and programming of counterpart funds reduced reserve money by 3.0%. If total unexpended balances were spent, reserve money would increase by 10.1%. This suggests the importance of looking at not just major recipients of US aid, but countries for which US aid, is a relatively large share of government resources. These data have not been examined in a systematic fashion in the literature. For the year reported, in the Sudan, counterpart funds reduced the money supply, although accumulated balances could have been quite expansionary if spent. The data for the other countries, however, suggest that counterpart funds are too small relative to the money supply to worry about their "inflationary" effects. For the countries reported, even if the data are understated substantially, the magnitudes are so small relative to reserve money that it seems safe to conclude that the monetary effects of counterpart funds should not be a serious concern. It would be possible to compute similar tables for all countries reported in "Status of Foreign Currency Funds" for 1988. Similar numbers could be computed over time as well. Doing so would clarify whether the 1988 data reported are unusual or representative of other countries and other years.

Using the available IMF data, the actual contribution of changes in counterpart funds to changes in reserve money and M2 are given in Tables 4 and 5. These data suggest that

[8] $M = u \cdot H$ where M is the money supply, u is the money multiplier, and H is reserve money. If all the CF on deposit were spent, $\Delta H = CF$. The money multiplier need not stay constant, but as an approximation this assumption probably does not affect the results substantially.

counterpart funds have not been an important source of reserve money or M2 growth. In fact, counterpart funds have just as often reduced the growth of reserve money and of M2 from what these growth rates would otherwise have been. This does not mean that spending counterpart funds in particular years has not had an important expansionary effect, but it does suggest that all the discussion of the "inflationary" effects of spending counterpart funds is perhaps overstated or misleading. In addition, in almost all cases, the effects of counterpart funds are small relative to other sources of reserve money and M2 growth.

2. The Effects on the Balance of Payments

The effects of commodity aid and foreign exchange aid on the balance of payments of the recipient country are discussed at length in the literature (Roemer (1989), Clement (1989), Nathan Associates (August 1989)). The effects depend on whether the aid is supplied on a grant or loan basis, whether it is supplied as commodity aid or foreign exchange, and whether total imports increase by the amount of aid or remain unchanged. For example, if commodity aid is supplied on a grant basis, unilateral transfers increase. If the commodity aid imports substitute for normal imports so that total imports remain unchanged, the current account will improve by the amount of the aid, since the aid enters as a credit item under unilateral transfers in the current account. Using the balance of payments identity (current account balance + capital account balance = change in international reserves) it is straightforward to see that some other item must change in the balance of payments accounts. Borrowing from abroad that otherwise would have occurred could decrease (reducing the capital account surplus), international reserves could increase, or some combination of these two could offset the improvement in the current account resulting from the foreign aid. Under some circumstances, exports may decline, offsetting some of the effects of the aid on the current account. This might happen, for example, if the real exchange rate appreciated.

If the commodity aid involves a loan, then there would be a credit in the capital account rather than in the unilateral transfers component of the current account. If exports and imports remain unchanged, the current account will remain unchanged and only the type of borrowing from abroad or the level of international reserves (or some combination of both) would be affected.

Commodity aid imports are said to be "additional" if total imports increase. In other words, the commodity imports made available by aid are not replacing imports that would have been purchased in the absence of aid.[9] If the commodity aid imports are additional, and if supplied on a grant basis, the current account would remain unchanged. The higher imports, a debit in the current account, would be offset by increased unilateral transfers, a credit. If supplied on a loan basis, the current account would decline since imports have increased given the additionality assumption. This would be offset by inflows on the capital account -- the loan which is a credit in the capital account.

Foreign exchange aid will increase unilateral transfers if supplied on a grant basis or will increase capital inflows if supplied on a loan basis. If imports remain unchanged under both situations, international reserves would increase, assuming exports and borrowing that otherwise would have taken place do not change.

Note that under a fixed exchange rate regime, the monetary base is affected if international reserves change. Referring to the Central Bank balance sheet, when net foreign assets increase, high powered money increases. If the balance of payments is in surplus (the current account plus the capital account, excluding changes in international reserves), then international reserves increase. This increases high powered money and the money supply. Therefore, the aid transfer, if it affects the balance of payments, will affect the money supply.

This effect is independent of the generation of the counterpart funds. It is the result of the aid transfer and would take place even if there were no counterpart funds generated. The counterpart funds generation is always associated with foreign aid, however, and the overall effect of foreign aid and counterpart funds on the money supply should include this channel -- the effect of the aid transfer on the money supply.

[9]We define "additionality" to mean that the total value of imports increases by the amount of the aid. One could define "additionality" on a micro level to mean that those particular imports supplied would not have been purchased without the aid, leaving unexamined whether they are replacing some other import that is a close substitute. What we care about here is the effect on the total level of imports.

A difficult question is whether imports will increase or not, and whether exports will decline or not. There is no presumption that exports will change immediately when the aid is supplied. If the price level ultimately changes, however, the competitiveness of exports could change which could affect export receipts. On impact, when the aid is supplied, the effects on the level of imports will depend on whether the initial import level was constrained by foreign exchange availability. If so, it seems more likely that aid will result in additional imports, by relaxing the foreign exchange constraint.

3. The Effects on the Government Budget

Commodity aid is a transfer of real resources to the government of the recipient country. There is consensus in the literature that the counterpart funds do not constitute additional (to the aid commodities or foreign exchange) real resources for the country as a whole. (Roemer (1989), Towsley (1976), Clement (1989)). The counterpart funds are generated when the government sells the commodity aid goods to the private sector or the foreign exchange to the private sector or the Central Bank. The counterpart funds are the government's claim on resources in the economy that it has gained through the sale of the commodity aid or the foreign exchange given to it by the donor.

Two issues that arise in the literature in relation to this are 1) whether counterpart funds should be treated as deficit financing or as government revenue and 2) how commodity aid and counterpart funds affect the overall government budget. On the first issue, Roemer recommends treating counterpart funds as deficit finance. A reason for doing this is that the government cannot count on continued aid flows as a revenue source. Clement, in contrast, argues that grants should be treated as revenue, that is "above the line." If supplied as loans, they should be treated as a financing item in the budget. The distinction is whether the government incurs a future obligation for repayment or not. It is unclear that this issue is of much importance. As long as counterpart funds are identified, whether they are located "above" or "below the line" seems of little importance. More important is the effects of counterpart funds on government spending and taxes.

The effects on the government budget depend on how the government responds to additional resources. The options are to increase government spending, reduce taxes, or reduce any previously required financing of any difference between spending and taxes. Different governments have responded in different ways and should be expected to continue to respond in different ways. It seems likely that the optimal response will differ country by country as well as over time.

Note that the effects of generating and spending counterpart funds on the money supply do depend on the effects on the government budget. For example, assume that total government expenditures do not change as a result of the commodity aid and the counterpart funds generated, and that the government is running a deficit and financing it by borrowing from the Central Bank. To make the example concrete, assume the government is initially running a deficit that it finances by borrowing from the Central Bank equal to:

$$\text{Deficit} = G^{o} - T^{o} = \triangle CBC^{o} = \triangle H^{o}$$

G^{o} is the initial level of government expenditures, T^{o} is the initial level of taxes, $\triangle CBC^{o}$ is the initial amount of borrowing from the Central Bank needed to finance the deficit. This equals the change in high powered money, $\triangle H^{o}$. Now the government receives commodity or foreign exchange aid which it sells to the private sector for CF^{o}. Government deposits at the Central Bank go up by CF^{o}, reducing central bank credit and high powered money by CF^{o}. Central bank credit is the difference between lending by the Central Bank to the government and government deposits at the Central Bank. counterpart funds are a type of government deposit, kept separate from others. Now assume the government uses CF^{o} to pay for some of G^{o}, which remains unchanged. Government deposits at the Central Bank go down by CF^{o}, increasing central bank credit and high powered money by CF^{o}, offsetting the initial effects of selling the aid to the private sector and creating the counterpart funds. The creating and spending of the counterpart funds have therefore had no net effect on the money supply. But now, the deficit that must be financed goes down by CF^{o}. Part of G^{o} has been paid for with the counterpart funds. The final change in the high powered money would be equal to the new gap between spending and receipts, or

$$\Delta H = \Delta CBC^{o} - CF^{o} = \Delta H^{o} - CF^{o}$$

The selling by the government of the commodity aid and the spending of the counterpart funds generated have no effects on the money supply, as discussed above in 5.1. But in this example, of course, the gap between taxes and expenditures is smaller than it would have otherwise been, and therefore the government needs to borrow less from the Central Bank. The increase in the money supply is smaller than it would be otherwise.

Another way of reaching the same outcome would be for the government to generate the counterpart funds and not "spend them". The counterpart funds would accumulate in the Central Bank. This would reduce high powered money by CF^{o}. But if the government does not spend these counterpart funds, then it must still finance its deficit $G^{o} - T^{o}$ by borrowing from the Central Bank the amount ΔCBC^{o}. The final effect on high powered money, just as in the earlier example would be:

$$\Delta H = \Delta CBC^{o} - CF^{o} = \Delta H^{o} - CF^{o}$$

The government would finance the gap between spending and revenue by borrowing from the Central Bank the full amount, ΔCBC^{o}, but high powered money would be smaller than otherwise because the sale of the commodity aid decreases high powered money by increasing government deposits at the Central Bank by CF^{o}. In both examples, the final effects on the money supply are identical and government spending and taxes remain unchanged. But in the first example, the counterpart funds are "spent" while in the second they are "not spent". This demonstrates that "spending counterpart funds" has little meaning independently of the overall macroeconomic policies of the recipient government, particularly its monetary and fiscal policies. Looking at the effects of the aid transfer on the government's expenditures and taxes (or the deficit excluding the aid transfer) are therefore important when analyzing the monetary effects of counterpart funds.

The other extreme example would be for total government expenditures to increase by the amount of the counterpart funds generated. In the absence of the aid and counterpart funds,

$$\Delta H^{o} = \Delta CBC^{o} = G^{o} - T^{o}$$

Now, with the counterpart funds and increased government spending paid for by the new counterpart funds,

$$\Delta H = G^{o} + CF^{o} - T^{o} - CF^{o} = \Delta CBC^{o} = \Delta H^{o}$$

Therefore, there is no effect on the money supply. Again, one could arrive at this result if the government increases government spending and uses the new counterpart funds to meet increased spending. Or, the government could leave the new counterpart funds "unspent," sitting in the Central Bank. But if government spending increases, then the government must borrow more from the Central Bank, offsetting the effects of not spending the new counterpart funds on the monetary base and the money supply.

Note therefore that the final effect of aid and counterpart funds on the money supply depends on what happens to the government deficit, defined to exclude the aid transfer, and on the effects on the balance of payments. Four extreme scenarios can be identified. Case 1: government spending (minus taxes) increases by an amount equal to the counterpart funds generated while imports remain unchanged; Case 2: government spending (minus taxes) increases, while imports also increase by the amount of the counterpart funds generated; Case 3: government spending (minus taxes) stays constant, and imports remain unchanged; Case 4: government spending (minus taxes) stays constant and imports increase. Assuming a fixed exchange rate, the effects on the Central Bank balance sheet and high powered money in each case would be as follows:

Table A: The Effects of CF on High Powered Money

	Imports constant	Imports increase by CF
(G - T) constant	Case 3 Δ NFA = +CF Δ CBC = -CF Δ H = 0	Case 4 Δ NFA = 0 Δ CBC = -CF Δ H = -CF
(G - T) increases by CF	Case 1 Δ NFA = +CF Δ CBC = 0 Δ H = +CF	Case 2 Δ NFA = 0 Δ CBC = 0 Δ H = 0

The effects of counterpart funds on the money supply therefore depend on the effects of the aid on imports and on government spending minus taxes. The money supply could increase, decrease, or remain unchanged. We will return to this issue below when we talk about whether counterpart funds are "inflationary" or "deflationary". Note that much of the confusion in the literature about the effects of counterpart funds on the money supply results from not clearly working out or not including at all the effects on the government deficit and the balance of payments.

To return to the effects of counterpart funds on the government budget, Roemer argues that counterpart funds should only be spent on expenditures in the existing budget. In this case, total government spending remains unchanged and, additional resources made available to the country by the aid (not by the creation of the counterpart funds) go to the private sector or foreign creditors. They would go to the private sector, either through a smaller inflation tax or less lending by the private sector to the government. Reducing taxes would have an identical result, through a slightly different channel. The additional resources made available to the country by the aid would go to foreigners if used to reduce borrowing from foreigners or to pay back debt. Unless one is willing to assume that the government's claim on resources is either always exactly correct or too large, this will not always be the best response. The aid, not the counterpart funds, is an additional resource, and if the government's claim on resources remains unchanged, some other sector's claim must rise, assuming output does not fall by an equal amount for some reason. This may or may not be desirable.

Clement has in mind primarily countries that have balance of payments and inflation problems. The assumption seems to be that the growth rate of the money supply always needs to be reduced and that the government deficit (because it is going to be financed by new money) should be reduced. The optimal response to the aid on the part of the government is to leave expenditures and taxes unchanged. The aid therefore reduces the amount of central bank credit from the Central Bank to the government that otherwise would have been necessary. In some of the literature on counterpart funds, it is argued that not spending the counterpart funds and not letting government spending increase will <u>both</u> contribute to macroeconomic stabilization goals, in particular slowing the growth rate of the money supply. Note, however, that the counterpart funds themselves can only be used once to reduce reserve money. The government cannot generate the counterpart funds and not spend them, which reduces the money supply, and also use them to finance previously planned government expenditures, which reduces any government deficit that needs to be financed by central bank credit. In other words, they can only be "used" once to reduce the money supply. Clement argues that "the accumulation (but not use) of counterpart funds may reinforce other macroeconomic policies aiming at reducing inflationary pressures and narrowing the balance of payments deficit." But then any gap between revenues and expenditures will be financed by net credit to the government. Surely, Clement would be indifferent between not spending the counterpart funds and using them to finance previously planned expenditures, which in the end are really identical events.

An issue that is not well discussed in the literature is what has actually happened in various countries. Does commodity aid and foreign exchange aid which generate counterpart funds tend to increase government spending, reduce tax efforts, reduce government borrowing from abroad or the private sector, or reduce borrowing from the Central Bank? Individual case studies in the literature discuss whether or not the counterpart funds are spent, but again, without information on the effects of the aid transfer on government spending and taxes, this gives little information on the effects of the counterpart funds on the final claim on resources within the economy.

The effects of counterpart funds on the government budget are important because the size of the budget is a government objective. The generating and programming of counterpart funds can either complicate or facilitate government budget policy, and therefore understanding their budgetary effects are important. On the basis of the data that we have been able to accumulate, the role that counterpart funds can play in budgetary decisions is quite small, except in a few countries, usually the smaller, poorer countries. Since counterpart funds are available to the government to finance expenditures, with donor approval, the size of the counterpart funds relative to government spending is of interest. The USAID data for five of the six countries reported in Table 2, suggest that counterpart funds are small relative to government expenditures. Both unexpended balances relative to government spending and disbursements relative to government spending are small. Even if the USAID data on counterpart funds are substantially understated in these countries, counterpart funds could not have had a large effect on the government budget. For the eleven countries for which there are data in the IFS, CF/G ratios are shown in Table 6. The IMF data are less complete than those of USAID when looking at the effect on the government budget because the number reported is the stock -- the counterpart funds on deposit at the Central Bank or in the banking system -- at a point in time. The number of interest when thinking about financing government expenditures would be disbursements during the year, a flow variable. Without information on deposits or disbursements, the change in the stock from year to year is of little use. For example, if the local currency equivalent of $100 were deposited at the Central Bank and then spent, the stock would be unchanged but the government would have used $100 local currency equivalent. Even so, the IFS data contain some relevant information. The ratio CF/G tells us accumulated counterpart funds that could be drawn down to finance government spending, excluding any new counterpart funds generated during the year. If these numbers are large, the counterpart funds are important relative to government expenditure. If they are not big, it is still possible that counterpart funds are important. The IFS data show that counterpart funds accumulated at the Central Bank are not large relative to government spending, in only a few cases exceeding 5%.

4. The Effects on Inflation

Closely related to the monetary effects of aid and counterpart funds is the issue of whether counterpart funds are "inflationary or deflationary," about which there is much discussion. The literature concludes, correctly, that there is no one answer to this question. It depends on both the effects of the aid and counterpart funds on the available supply of goods as well as on the money supply. The generation of counterpart funds is associated with commodity aid or foreign exchange transfers. Both commodity aid and foreign exchange transfers can either increase resources available to the economy or improve the balance of payments.[10] Aggregate supply increases if the aid is used to increase imports above previous levels. In this case, the aid itself, separate from the generation of counterpart funds, should contribute to lower prices.

[10] By the balance of payments, we mean the balance of payments excluding changes in international reserves.

Neither transaction, commodity aid or foreign exchange aid, must necessarily increase supply, since the transfer could be used to increase net foreign assets or reduce net foreign debt. In this case, the transfer is not used to purchase additional imports, leaving supply unchanged. (See J.P. Lewis, (1962), pp. 318-319).

If the aid does not lead to an increase of supply through higher imports, the aid will move the balance of payments toward surplus. Under a fixed exchange rate system, this will increase international reserves and the monetary base. It is important to remember, however, that these are all effects of the aid, independent of the generation of the counterpart funds.

The aid also will affect the government budget, which again can affect central bank credit to the government, which in turn will affect the money supply. Therefore, the final effect of the aid and counterpart funds on the money supply depends on what happens to the balance of payments as well as to the government budget in response to the aid as was discussed in detail above. The aid plus counterpart funds will be most "deflationary" when imports increase, increasing supply and avoiding an increase in the monetary base from increased international reserves, and when government spending and taxes remain unchanged, leading to a smaller increase in Central Bank credit to the government than otherwise. Whether this is the appropriate policy or not, depends on the state of the economy. If inflation is a problem, then increasing available supply and avoiding an increase in the money supply as a result of aid and counterpart funds would be desirable. But in other countries, at other times, inflation may not be a problem and it may be more beneficial to use the aid and counterpart funds to increase government spending than to reduce the growth rate of high powered money.

Since counterpart funds may or may not increase both the money supply and aggregate supply of goods and services, legitimate questions might include the following: Have counterpart funds tended empirically to have expansionary effects on the money supply in recipient countries? Have counterpart funds led to an increase in imports and therefore aggregate supply? Have these effects together led more often to inflation or deflation? There is much less discussion of these issues in the literature. As discussed in the data section, in most countries the size of counterpart funds outstanding is too small to spend much time worrying about their monetary and inflationary effects. In some other countries, during different time periods, concerns about these effects are legitimate.

5. Do counterpart funds represent additional real resources beyond those of the actual aid?

There is a total consensus that the counterpart funds do not represent additional real resources to the recipient country economy. The real issue here is whether aid with the counterpart funds mechanism compared to aid without counterpart funds can have a greater, positive effect on development. On this issue, there is not a consensus, as discussed in detail in Chapter 3.

6. The Effects on the Exchange Rate

The exchange rate effects of aid and counterpart funds are not discussed in the literature, but given the effects on the balance of payments and the money supply, models of exchange rate determination can be used to analyze these effects. In most of the literature on counterpart funds, a fixed nominal exchange rate is assumed. For most developing countries, this is the appropriate assumption. Then it is of interest to think about the effects of aid and counterpart funds on the real exchange rate. This will depend on the inflationary effects of the aid and counterpart funds, which have been discussed at length. Any time the aid plus counterpart funds is inflationary , with a fixed exchange rate, the real exchange rate will appreciate. A benefit of the aid is that it can relax a foreign exchange constraint. But if the aid and counterpart funds prove inflationary and lead to an appreciation of the real exchange rate, net exports may fall from what they would have been in the absence of aid.

Under a flexible exchange rate system, one needs a model of how the exchange rate is determined to analyze the effects of aid and counterpart funds on the nominal exchange rate. One possible model assumes that the exchange rate moves to keep the balance of payments, excluding changes in international reserves, in equilibrium (equal to zero). In this case, the aid will lead to an appreciation of the exchange rate if it improves the balance of payments. Aid acts like a commodity boom and has "Dutch Disease" effects. (Under a fixed exchange rate, aid can have the same effect when it improves the balance of payments, but through price changes that appreciate the real exchange rate.) The monetary effects of the creation and spending of counterpart funds will also affect the exchange rate. An increase in the money supply will depreciate the exchange rate.

The effects of aid and counterpart funds on the real exchange rate, under fixed and floating exchange rate systems, is an important issue that deserves more attention. If one believes that aid contributes to development by relaxing a foreign exchange constraint, then if the real exchange rate appreciates, part of the benefit of the aid is offset and the country may be worse off if aid is discontinued than it would have been otherwise.

7. The Problems of Large Balance Countries

Problems have arisen in countries where very large balances of counterpart funds have accumulated and it is generally agreed that it is not good to have large counterpart funds balances create both economic and political problems. Historically, India is a good example of the problems that can arise. The problems of large balance countries relate in part to the monetary effects of counterpart funds. Large balances can accumulate only if counterpart funds are generated and not spent. This implies that the generation of counterpart funds has contributed to reducing the monetary base and the money supply. Of course, the actual money supply need not have declined depending on offsetting transactions taken by the government. For example, as discussed above, if government spending was financed by borrowing from the Central Bank rather than by spending counterpart funds, the effect on the money supply would be the same, given the level of government spending. One problem with large accumulated balances is that if spent, they may have an expansionary effect on the money supply at the wrong time, and the government may have greater difficulty offsetting or sterilizing large expansionary effects on the money supply than offsetting smaller reductions in the money supply spread over several years. But of course, the recipient government need never agree to spend the large accumulated counterpart funds, so why are they a problem? The following statement by then Ambassador Moynihan on the Indian Rupee Settlement, which dealt with large balances in India, (from "The Indian Rupee Settlement Agreement," (1974)) suggests why:

> The agreement would remove us from our present deep involvement in Indian financial and monetary policy decisions, where we no longer wish to be and are not wanted. The Indians are naturally concerned over the possibility that we might use our

> rupees in an inflationary or disruptive manner. This fear is largely psychological; there is no basis in fact for it. Nevertheless, by placing a greater distance between us, and lessening our potential involvement in Indian financial matters, the agreement contributes directly to building a more mature, balanced and healthy relationship with India. We both recognize and welcome this. (p. 7)

A statement by the then Comptroller General of the US in the same document suggests similar concerns:

> It appears that the large US rupee balance in India is causing some problems in Indo-US relations because of (1) Indian anxiety over potential difficulties that may arise as a result of misunderstandings regarding the nature of US holdings and (2) representations by Indian politicians who wish to embarrass the United States by claiming that the United States through its rupee holdings is somehow largely controlling the Indian economy.
>
> In our opinion, the decision to reduce substantially outstanding balances of US-owned rupees in return for improved foreign relations is a policy matter deserving congressional attention. (p.64)

Large balances, as in India, can be problematic and generate ill-will between donor and recipient. The reasons for this, however, are probably only partly, if at all, related to the monetary control issues. More important may be the issues of control over recipient country spending decisions or overall macroeconomic policy. But again, the recipient country need never agree to spend the counterpart funds. In the end, large counterpart funds balances may be more of a political problem than an economic problem. To allow them to accumulate and generate ill-will seems unfortunate. Lewis discusses the Indian case and argues that the inflationary potential of counterpart funds was perhaps the most prominent argument against counterpart funds in India, but the least important (Lewis, (1962), p. 317). He discusses concerns similar to those of Moynihan quoted above.

8. Who should own the Counterpart Funds?

Starting in the 1940s and continuing through the 1970s the US government owned the counterpart funds and either gave or lent the local currency to the recipient government to use for agreed purposes. Later, the US shifted toward the recipient government owning the counterpart funds, with use requiring US approval. Does one of these arrangements work better than the other? It depends on whether one believes counterpart funds can play any role at all, of course.

If not, then this issue is irrelevant. The answer would be that they should not exist. But assuming that counterpart funds can play a role, who should own them will depend on the country's circumstances. In a case where the government is extremely ill-prepared, where counterpart funds are protecting particular expenditures, it might make sense to have the US own the counterpart funds. This somewhat paternalistic position may yield great benefits in some circumstances. In all other circumstances, it seems that the recipient government should own the funds. Aid in part will have achieved its goal when no US advice or additional aid resources are necessary. Having the recipient government own the funds moves in this direction.

9. How much Counterpart Funds should be generated for each dollar of aid?

This has been an issue with food aid for a long time and is also of concern with cash transfers. With both, the appropriate exchange rate to use is an issue. If the exchange rate is "overvalued", then less local currency will be generated for each dollar of aid than would be otherwise. The dollar price and/or local currency price of commodity aid goods also matters. For example, if using the prevailing exchange rate, US dollar food prices are greater than world prices or prices in the recipient country, how much local currency should be generated? Should the donor or recipient price be used?

Again, one's view on this in part depends on one's views on the role of counterpart funds. If one thinks they are of little use, presumably one would not spend much time on this issue. If useful, then the important point will be not to let this issue create ill-will between donor and recipient. The potential positive effects of counterpart funds do not depend on their precise local currency quantity. They depend more on the relationship between donor and recipient. It might seem at first glance that the donor would prefer large amounts of counterpart funds and the recipient smaller amounts. But this is not always the case. Certainly to the extent that counterpart funds represent resources available to the recipient government, the government will also have an interest in not "underpricing" the real resources of the aid.

Zimbabwe is an example of where problems have arisen. Some of the recipient country's firms that were purchasing commodity imports felt that the US prices of the imports were higher than substitutes from other countries. This was the result of both the appreciating dollar and higher shipping costs from the US. A higher dollar price implies more counterpart funds generated, assuming that the market clears. But given that the imports were purchased, the price in domestic money was not too high. Given the foreign exchange constraint, the exchange rate was overvalued. The true domestic currency equivalent value of the imports would have to take both distortions into account. ("An Evaluation of the Zimbabwe Commodity Import Program", March 1984, p. 12.) If the US goods were truly "too expensive", they would not sell. In Egypt, for example, a subsidy was needed to sell some CIP goods. (Lieberson, March 1985, AID Evaluation Occasional Paper No. 4, p. 3.)

The counterpart funds deposited should at least equal the market price in the local market. Lieberson (March 1985) reports that often importers buy CIP goods at one price (based on the official exchange rate) and then sell them at higher prices in the private market. The importer earns a windfall gain as a result of the overvalued official exchange rate. Certainly there is no reason for the importer to get the windfall, rather than the government. If the government desires to transfer resources to the private sector, it can do so in a more neutral manner than allowing windfalls to accrue to specific private importers.

Chapter 6. Some Detailed Stories

In this section we explore in greater detail some of the analytical aspects just reviewed that seem to us to be particularly important in understanding the role that counterpart funds can play in development and in the aid programs of the United States. We do this with a series of stories in which rather specific assumptions are made about the various aspects of the process that were identified in the previous section. To proceed in this manner helps to concentrate explicitly on those aspects of the arrangements that seem to us to be less well-studied in the literature and on which some confusion seems apparent. In particular, it permits us to point up the importance of the 'initial conditions,' i.e., the state of the economy at the time the process begins. Similarly, we believe that the effect on the real exchange rate of aid that leads to counterpart funds can be seen more clearly in our stories than is now the case in the literature. These are both relevant in determining the impact of the counterpart funds process, and help to explain and justify the interest in the more frequently examined effects on money supply. This approach also helps us set the stage for our case studies in the last section. We therefore arrange our stories around specific assumptions about initial conditions.

We begin with stories about commodity aid programs and then consider how these differ from aid in the form of cash.

A. Counterpart Funds Generated by Commodity Aid

Story 1. Counterpart Funds in an Economy in Equilibrium

In the beginning period the donor provides a grant of commodities to the recipient government. These commodity imports are in addition to current imports and the aid program is assumed to continue for the foreseeable future. The recipient government immediately sells the commodities to private dealers at the 'world market' price converted to local currency at the official exchange rate. The donor agrees that the price and exchange rate used are acceptable. The government is paid by the dealers with a check drawn on their accounts in the commercial banks.

Assume the government deposits its counterpart funds in the Central Bank. Government deposits in the Central Bank rise and those of commercial banks fall. If the banks were loaned up when the transactions began, they must now retrench by an amount determined by the reserve requirement. In this event, money supply will surely fall if no compensating activities take place. What happens to prices and output depends on how the system adjusts to the decline in money, and will be discussed in a moment. Note that it matters whether the government deposits its new receipts in the commercial banks or puts them in the Central Bank and thereby affects the reserves (the high powered money) of the system.

In this initial period there are two immediate consequences for the economy. The first is that there are more goods and services available without increased production, i.e., without income being generated in their production. The government's income goes up by the amount received from the sale of the aid commodities, and aggregate supply exceeds aggregate demand relative to the situation before the receipt of the aid. The second is that money in the hands of the private sector has been reduced. The latter works in the direction of reducing aggregate demand that is brought to bear in the market. The effect of these two events depends on the state of the economy at the time of the transfer. Suppose the following is a fair description of the economy at the time of the transfer; that is, of the initial conditions of the economy.

i. The current account of the balance of payments is in equilibrium at an exchange rate that accurately reflects the productivity of domestic resources. This position is deemed sustainable.

ii. The government budget is in balance in the sense that there is no domestic or foreign borrowing or printing of money.

iii. The banking system is loaned up to that allowed by existing reserves.

iv. It follows from the preceding that aggregate demand and aggregate supply are equal, ex ante, and it is further assumed that this equality is sustainable.

v. There is full employment in the sense that there is an absence of open unemployment and that an increase in the demand for labor will tend to push up wage rates.

vi. The productivity of labor is extremely low and income and consumption are just about subsistence level.

In these circumstances the commodity aid is justified on the grounds of the severe poverty and the inability of the economy to relieve that poverty. Commodity aid in the form of food combined with the counterpart fund creating process would then be aimed at two objectives: raising consumption standards as a humanitarian act and also contributing to the emergence of an economy in which the productivity of the resources available to it are being continually enhanced. If the imported commodities are capital and intermediate goods, then consumption can be increased by the fact that some domestic resources are freed to produce additional consumption goods at home. It is essential to recognize that both of these objectives are to be served by the commodity aid for a country with the six characteristics listed above. To repeat: the commodity aid transfer increases goods available to the economy for consumption and investment. The counterpart funds mechanism gives control over these resources to the government which it may then use with donor approval.

The donor plays two roles. The first is that of providing the commodity grant. So it makes a transfer and determines, or is involved in determining, the commodities whose supply is increased for the recipient country. This latter effect may be no small issue and can have an effect of how development proceeds in the recipient country. As noted in the introduction, it is not an issue that we pursue in this paper, except here and there to call attention to its relevance.[11] The second role that the donor plays refers to the influence it has over the uses to which the counterpart funds are to be put. These funds are presumed to be used for development purposes, i.e. used in such a way that the productivity of domestic resources will begin to rise. So then we emphasize that there are two roles for the donor to perform in this process.

It is evident that the availability of commodities has increased by the amount of the transfer from the donor, not by that amount plus the counterpart funds that are generated. The counterpart fund arrangement does mean that funds have been transferred to the government from the private sector by the sale of commodities, without an increase in taxes or borrowing. The process also means that the donor gains some role in how these newly available funds are to be used.

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[11]The fact that surplus food supplies were available in donor countries was, as noted earlier, a factor in the form that aid took in the beginning of large scale United States aid to developing countries. It also seems to be the case that the actual content of commodity aid in general is frequently affected by conditions (and lobbying groups) in the donor country. This fact then affects how development occurs in the recipient country.

There are now two further questions: How should the government compensate for the reduction in the money supply? And, assuming that the government does increase its spending, on what should it spend?

Consider the first question first. One possible answer is that the government should do nothing, not compensate in any way. In the present story, to support such non-action, it would have to be argued that a reduction in the money supply has no real effects on the economy. Prices would fall rapidly and (probably) velocity increase somewhat so that the unchanged money supply could clear the market without forcing a reduction in the level of activity resulting in the underutilization of available resources. This is unlikely. Instead, interest rates would surely be pushed up, dampening investment, and there would be some decline in consumption as the reduced money supply made all forms of credit tighter. It is also doubtful whether such an approach would contribute to the second objective of commodity aid -- increased productivity of domestic resources. Saving might possibly increase, but the rise in the interest rate is likely to be such that investment will not respond, and so the underutilization is exacerbated.

In many situations, a major part of the rationale of the counterpart fund idea rests on the argument that it is especially important to the development objective to get additional resources to the government. The idea, in the present story, is to enable the government to do something that it was not doing previous to the aid. Thus the government should take advantage of the fact that additional resources are made available to it.

We conclude then that the situation (increased supply due to aid) requires an equivalent increase in aggregate demand at prevailing prices. This increase in aggregate demand can originate with the government. If the government increases spending by the amount of counterpart funds generated, the money supply will return to its initial level. This increased spending in the economy will not be enough to eliminate the excess supply since the increased expenditures combined with a constant money supply will increase interest rates and crowd out some demand. Therefore, increased spending equal to the counterpart funds must be accompanied by additional stimulus, for example, by an increase in the money supply. To say only that the government must spend the receipts of the sales of the aid commodities -- the counterpart funds -- immediately may be misleading. Additional demand, beyond the spending of the counterpart funds, is required as the aid commodities are supplied or excess supply and underutilization will most likely appear. One possibility is for this increased demand to be brought about by increased money supply, originating with government borrowing from the Central Bank. (There are other possibilities, but they seem less feasible in most countries.) This point is rarely noticed in the literature, and may well be an important explanation of why there is so little evidence that the spending of counterpart funds is inflationary.

Now suppose that the recipient government has appropriately in this example decided to use its newly available control over domestic resources. The question of how to use such funds must now be addressed. There appears to be no general criteria to determine what is an appropriate project to be financed by counterpart funds, in contrast to spending from other funds available to the government for development. Thus one answer to the question of how to use counterpart funds may well be, include the counterpart funds in with the general development funds. This is in fact the practice in some countries and has often apparently worked well. If it always worked well, the basic question would be resolved: just add the counterpart funds to the general development budget and use them as the development program dictates. If this always worked well, there would be no need for using the counterpart fund approach. We do not, however, believe that this is an adequate answer in all cases. In a number of cases such a procedure has not worked well, and there are a number of other complications. In the next section, we examine several examples of counterpart fund use to try to identify specific characteristics of projects and situations that have turned out well and of those projects that appear not to have been so successful. In the present section we content ourselves with some rather general observations on the question.

In an economy with the characteristics listed above, the question of how to use the counterpart funds rests largely on one's views of how development can and should take place. We noted in the introduction that there is hardly a conventional wisdom on this question, and evidently legitimate disagreement can arise over broad strategies of development as well as over very detailed questions. The donor is in an especially awkward position in such debates in the present context because rather obvious objectives -- eliminating inflation, solving a balance of payments difficulty, correcting an inappropriate exchange rate, eliminating a deficit in the government's budget, etc. -- are not applicable, given our present assumptions. (We relax these assumptions in the following discussion.) Thus the questions necessarily are basic to the development problem: namely, why is this country so poor and productivity not rising?

A more specific question that emerges directly from the counterpart approach is: Will greater resources made available to the private sector contribute more to the development objectives than greater investment in the public sector? Note that the question must apply to a specific country at a specific time period. On this question, the donor may not be in a very strong position; the donor may not, probably does not, know as much detail about the prevailing situation as do the officials of the recipient country. At the same time we recognize that the donor may be able to play a role in the decision of how the counterpart funds should be used. As a result of donor participation, the allocation of funds will be different from what it would have been without donor participation. If this were not the case, then of course there is no reason for donor participation.

The analysis of Chapter 5 made clear, that the recipient can compensate for any reductions in the money supply that results from generating counterpart funds by borrowing and spending an equivalent amount from the Central Bank. This is not, in the present circumstances, inflationary, and enables the recipient to do as it pleases, and the counterpart funds simply accumulate. We have found no evidence that the donor ever has the authority to require that counterpart funds be spent. Spending the counterpart funds immediately has the advantage that they do not accumulate into a large amount relative to the money supply, income or some other variable. The literature is virtually unanimous in arguing that such accumulations have many unfortunate consequences, although there are divergent views on exactly why they are unfortunate.

The literature frequently notes that counterpart funds are used to ensure that the local currency requirements of the donor's aid project are met. Except for the fact that a donor likes to be sure that its particular project will not run into a local currency bottleneck, there is no economic rationale for such an arrangement. A more complex argument refers to the use of the funds to finance policies (taxes, subsidies, etc.) that may be essential if the commodity imports are to have the desired effect. For example, imports of any aid commodity may in fact have adverse effects on domestic producers that it is appropriate to offset, and counterpart funds may be used for that purpose. Thus, food imports may need to be accompanied by a price subsidy to domestic farmers to prevent domestic agriculture being penalized. In the following section we will pay more attention to the use of counterpart funds to implement policies aimed at the general objective of enhancing the productivity of domestic resources as well as making the aid commodities more effective. This notion is contrasted with that of using the funds to buy certain products.

Since the counterpart fund generation results in a withdrawal of purchasing power from the income stream as more commodities become available, it is important that this effect be offset in this first period. If this is to be done by spending the counterpart funds, this means that agreement on their use in this example should be reached at the same time as the arrangements for the import of the commodities are completed. The fact that counterpart funds can be "spent later" does not prevent the underutilization of resources now to result in a loss of output that can never be made up. This point raises doubts about the extent to which the existence of donor influence over the use of counterpart funds constitutes an independent source of "leverage," a source of influence in addition to that provided by the commodity aid. (This point is also noted by Lewis (1962) and Towsley (1978)). In the present context, the total package -- commodities and counterpart funds use -- should be decided together. Evidently considerable lead time is necessary if such a process is to work reasonably well.

These arguments suggest rather strongly that, in an economy of the kind that we are currently considering, using the counterpart funds to finance projects that the government chooses to include in the development budget makes a great deal of sense. In this case the donor should concentrate on the development budget as a whole, not just a project or two in it. This, we note again, has been done with success in a number of countries, but it won't work in all countries.

Conclusion to Story 1

Given the six initial conditions listed earlier, our conclusion is fairly specific. The new funds made available to the government by the foreign aid should be spent as soon as the commodity imports are available in the economy in order to capitalize on the availability of the additional resources. It is therefore especially important that agreement on their use be reached before they are created and before the arrival of the imports. There seems general agreement in the literature that the most suitable time for the donor to exercise what influence is deemed appropriate is during the negotiations for the commodity imports, not after their arrival. In the present context, the counterpart funds do not (and indeed should not) provide "leverage" in addition to that allowed by the commodity imports. We found reason to conclude that, if the government is able to maintain stability and high levels of employment, it will have a good idea of the best use for the counterpart funds. This argument does not mean that the donor should not discuss projects, policies, development objectives, etc. with the recipient country. It means rather that the donor should not conclude that it knows best on projects and policies and, especially, on development objectives.

Story 2. Counterpart Funds in an Economy with Excess Aggregate Demand

The economies of most developing countries can rarely be described by the six characteristics listed in the previous section. The most frequent departure from a sustainable aggregate position is that planned expenditures exceed available supply at existing prices. More completely, demand created by expenditures on consumption, investment, government purchases of goods and services, and on exports exceeds the supply of goods and services made available by production and imports. Since such an excess cannot exist in fact, something must occur to bring about equality *ex post*. If long term capital inflows that are deemed suitable equate the two sides (thus allowing imports to exceed exports), then there is no problem. The whole idea of both long term capital inflows and foreign aid is to permit the planned inequality between domestic output and expenditure to obtain *ex post*. In such a case, it is hoped that investment and other productivity enhancing activities will take place in such a way that equality of supply and demand in the future will be sustainable without either aid or loans at a higher level of output.

In the absence of such planned and acceptable capital inflows, one of three possible outcomes (or some combination) will obtain: a constantly falling level of foreign exchange reserves, a situation that is obviously unsustainable; unplanned borrowing; or an inflation that forces some category of spending to be reduced (in real terms) below that initially desired and planned. In the present story, we study the commodity aid/counterpart fund creating process in an economy experiencing inflation.

It is useful to identify two categories of excess demand inflation. In the first place, one can imagine an economy that is working well in terms of the allocation of its resources and that has fully employed resources, but is trying to spend more than it can produce domestically and import more than exports plus long term equlibrium capital flows. The problem is one of excess demand, and the objective is simply that of reducing total demand in the economy. In the second place, and this seems more common, the economy although suffering inflation, is not able to use all the resources that it has available to it, at least not in the most productive way. That this is the case can be explained by a number of things -- an incomplete or badly working market, a planning system (where employed) that is and has been defective, a complex of other policies (tariffs, subsidies, etc.) that lead to widespread distortions and misallocations, etc. This situation obviously complicates the analysis because now it is necessary to recognize that supply can be increased, i.e. the problem is not only on the demand side. We identify the first as a pure excess demand inflation and the second as structural inflation, and consider each of them in turn in the context of commodity aid and counterpart funds.[12]

a. Pure excess demand. The recipient country is similar to the one discussed in the previous section except that there exists excess aggregate demand. In a situation where the

[12]Since output is, in most instances, increasing, the distinction between the two inflationary situations can be put in terms of rates of growth of demand and supply. For the Pure Excess Demand case, the economy is operating at the right point on the Production Possibility Frontier. This frontier is moving outward, the economy stays on the frontier, but demand is growing more rapidly than the production frontier is moving outward, so the inflation pressure is generated. The objective is to slow down the growth of demand until it is equal to that of supply. In the case of structural excess demand, the economy is operating within the production frontier because of the distortions and bottlenecks. Output is increasing, but the economy continues to operate within the production frontier. Demand here is also growing too rapidly, but now the task is to correct the distortions and break the bottlenecks so that the economy can realize the full capacity of its resources. Thus the policy maker wants to affect supply as well as demand.

country has no foreign exchange reserves and cannot borrow abroad, the excess demand will produce rising prices. The rising prices force some of the economic agents to reduce their planned or desired spending in real terms until the total demand is reduced to the supply that is available. Which economic agents are forced to do less than planned depends on a number of factors, some of which will be examined below. (If there are price controls that prevent prices from rising, then who is forced to retrench is determined through explicit decision by some government agency.)

Consider first how commodity aid and counterpart funds enter into this story. Suppose that it is agreed by both donor and recipient that the immediate objective is to eliminate the excess demand. (This agreement is, of course, not always forthcoming, but this objective seems less likely to lead to serious disputes than those that have to be reached in the previous story.) Now a commodity aid program is begun and counterpart funds are created as already described. Since excess demand is the problem, the aid plus counterpart funds should be used in the most "deflationary" way, as discussed in Chapter 5, Section 4. This process produces two sources of anti-inflation pressure -- more goods in the market, and their sale which pulls purchasing power from the private sector to the government's account. This increases counterpart funds at the Central Bank, and reduces the money supply. In this example, the counterpart funds could be used to retire government debt held by the Central Bank. In this way the government buys back the bonds it had sold to the Central Bank and against which the Central Bank issued money. Using the counterpart funds to purchase government debt held by the Central Bank is preferable to hoarding them to be used at a later date. As already emphasized, accumulated counterpart funds are often a source of acrimony, and have little going for them logically.

As an anti-inflation device this use of aid and counterpart funds is a potent, straightforward instrument. If the inflation is of modest proportions and the amount of aid is relatively large, then it can be an effective means of overcoming the excess demand situation and the corresponding inflation. (If the inflation is of massive proportions, then this approach is not likely to be very effective.) Since so many developing countries do suffer from chronic inflation, it is tempting to conclude that this process should be a routine way of using the counterpart funds. Note that the funds are being used for development purposes in this story, since it is a basic premise of the whole process that the excess demand and the resulting inflation are harmful to the effective functioning of the economy. So removing the excess demand is the right use of the counterpart funds at the moment. If in later periods, as aid continues, the excess demand (net of aid) is removed, then we revert to the previous story.

Remember that for aid plus counterpart funds to have the most deflationary effect, the government must not spend the increased real resources made available to it by the aid. Thus, the increased supply provided by the aid must not be met with increased demand on the part of the government. It may indeed be the case that the excess demand was created by the government's own efforts to bring more resources under its direct control in the first place. The recipient's agreement to "sterilize" the counterpart funds implies that it is saying that it does not want more resources under its direct control. The recipient government does not reduce its expenditures, it just does not increase them.

In those countries where it seems that the development objective is best served by no further increases in the government's role in the economy, this approach will help accomplish that. Where, on the other hand, it seems that the government's role should be increased, this approach is less appropriate. Perhaps the best argument for sterilization of the counterpart funds in this latter case is one based on the importance of eliminating the inflation first, and then effecting the transfer of control over more resources to the government. This argument suggests that not spending the counterpart funds in the inflationary periods, and storing them for the future when the inflationary pressure is eliminated or purchasing back Central Bank held governmenbt debt, may be an appropriate procedure. If stored, at the later time the counterpart funds could be used by the government, with USAID approval, on legitimate development activities. Of course, at a later time in the absence of inflationary pressure, money financed increases in government spending could also be undertaken.

It seems useful at this point to call attention again to the role of institutions and decision-making in countries of all kinds, especially in those with inexperienced bureaucracies and undeveloped financial markets. The sterilization of counterpart funds used to dampen inflation pressure may make sense in a particular country and at a particular time simply because the government can commit itself in the required manner. A government may, for example, genuinely want to finance the deficit without printing money, but simply not be able to.

b. Structural Excess Demand. Excess demand is often, indeed usually, accompanied by distortions in the economy. Such distortions are often caused by the inflation, and they, in turn, fuel continued inflation. Sometimes distortions are exacerbated by efforts to control inflation, sometime by other policies of the government, and by the general incompleteness and inadequacy of markets in most developing countries. These structural characteristics add complexity to the task of halting the inflation in the manner described in the preceding section. With structural excess demand, simply reducing the money supply as the aid commodities become available is not sufficient, and will almost certainly result in reduced employment and output, and, in some cases, not dampen the inflation. If the distortions are severe enough, it may in fact be the case that there would be no excess demand in the absence of the distortions, i.e. correcting the distortions would result in the economy performing so much better that supply would increase to match the existing demand without inflationary pressure. In such a context, it may be that the most effective use of the counterpart funds is to spend them, not to use them as a means of reducing the money supply. The question, of course, is how the government might use the additional resources to correct the distortions and break the bottlenecks that have forced the economy to operate within its production transformation curve. The idea then is to use the counterpart funds to enable the government to act on the supply side as well as on the demand side, rather than go all out to reduce aggregate demand.

There is therefore more of a role for the government in this kind of situation than in the pure excess demand case. The general idea is to eliminate the distortions and bottlenecks, and this, in general, requires government action of some sort. It may also be noted that in the presence of distortions and bottlenecks, the composition of the aid commodities becomes more strategic.[13]

[13]Where bottlenecks can be broken by the increased supply of specific commodities, such commodities obviously are the ones to import. They are the anti-inflation instrument, not manipulation of the money supply. So the composition of imports may be a strategic policy variable.

Since so much depends on the nature and source of the distortions and bottlenecks, generalizations are dangerous. Some examples may make the argument clear -- as well as point up the importance of understanding the way the economy functions. Suppose that there is considerable underemployment in the system, but that wage rates are rising, possibly more rapidly than prices, so that real wages are increasing in the face of the underemployment. A rise in real wages in a situation with underemployment means that the labor market is, in some way, distorted. Can counterpart funds be used so as to correct this flaw in the labor market? In this case it may be possible to design and implement a wage subsidy with the counterpart funds that would dampen this upward pressure on wages, and hence prices. Increased government spending of counterpart funds that had this effect could well be much more anti-inflationary than using them as a means of reducing the money supply. Exactly what such expenditures should be, of course, depends on the source of the difficulty in the labor market. Similarly, increased outlays that had a significant effect on the capacity of the taxing bureaucracy to levy and collect taxes might be a powerful anti-inflation and bottleneck breaking instrument. Subsidies are generally (rightly) criticized, but subsidies that induce increased output and, especially, increased productivity can well dampen inflation, rather than add to it. Thus, if a major source of inflation pressure arises from the sluggish output of building materials, a subsidy that made it profitable to increase productivity in key sectors of this activity could dampen, the upward pressure on prices that resulted from this bottleneck. A similar argument might apply to agriculture. It must be noted also that government policies (including subsidies) often create distortions and bottlenecks. Even here, it might be possible to use counterpart funds to help modify such policies.

A final example is especially illuminating. Suppose that it is agreed that the local currency is overvalued and that a devaluation is very much in order, but both donor and recipient agree that a devaluation would feed the inflation. Both the composition of the commodity aid and the use of counterpart funds may be so designed that devaluation can take place without adding to the inflation problem. Imports that greatly increase the supply of goods that are facing strong excess demand help defeat inflation. Counterpart funds used to encourage increased productivity of a product that the devaluation made exportable would be anti-inflationary.

Other examples could be cited. There is no set rule and much, indeed everything, depends on one's understanding of how the specific economy is organized, the pattern of bottlenecks, and where the inflation pressure seems most important. Evidently there is a lot of room for disagreement between donor and recipient (and between almost any other pair of observers). We would insist however that in the present story -- an inflationary situation with substantial distortions -- the best approach is not necessarily using the counterpart funds to reduce the money supply. If, however, the situation is of high inflation caused by rapid money supply growth, combined with many distortions, it may be best to first correct the former problem. The counterpart funds mechanism can contribute, but would be unlikely to be enough.

Story 3. Counterpart Funds in an Economy with a Balance of Payments Problem

In the preceding story we assumed that there was no access to foreign borrowing, and hence the excess demand resulted in rising prices (or with controls, some other form of rationing) and could not produce a balance of payments problem. When does a country have a balance of payments problem? The most appropriate notion seems to be the following: imports in recent periods have exceeded foreign exchange earnings from the exports of goods and services, and the excess has been paid for by borrowing abroad, by suppliers' credits, drawing down reserves, etc., methods that may not be sustainable for very long. To cut back on imports to relieve this situation may lead to reduced employment and output or produce inflation. Aid financed imports will then replace current imports that are being paid for by these temporary expedients and allow the country to avoid reductions in imports. These aid financed commodity imports -- unlike those in the previous stories -- are not additional, they reduce foreign borrowing that was deemed undesirable and unsustainable.

If the balance of payments problem were caused by a pure excess demand situation, then the right approach would be that described in the story on Pure Excess Demand. Alternatively, it may be the same situation as that described under the heading of Structural Excess Demand: there must be some distortion in the economy somewhere. In this situation, the distortions are reflected in the form of too many imports, given the country's capacity to earn foreign exchange. The use of the counterpart funds that accrue to the government as the aid commodities are sold should then be employed to correct the particular distortions that are resulting in the excess imports. What these are again must be determined by an examination of the economy.

Since the aid commodities are not now additional, the supply of goods and services has not increased. This means that the government is somewhat more restricted in what it can do than in the case where the aid did result in additional commodities. Restricted means only that, since there is no increase in the available supply, the government will have to be more alert to whether its use of counterpart funds increases demand.

One should note that there can be an effect on the exchange rate in this situation. Clearly the pressure on the balance of payments has been eased, and, if the exchange rate floats, pressure on the exchange rate will also ease. Whether this is a favorable development depends on a number of considerations, but in general one can be reasonably sure that exchange rate appreciation is not desirable.

Story 4. Counterpart Funds in an Economy with Soft Government and Weak Bureaucracy

In many countries receiving foreign aid, the government is in the process of learning and accumulating experience on the management of the economy. Special note should be taken of this fact because, so it seems to us, the literature often is critical of the recipient country because it is a less developed country. As one thinks about what the appropriate policy or import composition or allocation of counterpart funds is, one must factor into the argument the recognition that the recipient country is in fact a less developed country with, in many cases, little experience in independent governance.

These rather obvious conditions are relevant not only with respect to what projects are undertaken with counterpart funds, but also with respect to the kind of reporting, implementing, record keeping, etc. that is imposed and expected. In many of the audits and other studies of the uses of counterpart funds, we found frequent references to inadequate inventories, mixtures of funds, poor accounting, ineffective controls, poor construction, etc. It is a fine line that has to be drawn between such characteristics as a consequence simply of the fact of being less developed and as a consequence of negligence, lack of interest, or downright malfeasance. As we stated in the introduction, management issues are not the concern of this study, but it is useful to note them here, because they often have relevance for the use of counterpart funds. Consider a few examples.

A government may be especially ill-managed and suffer from rampant corruption. It may at the same time tolerate foreign assistance activities, and indeed may even welcome them. It may also be appropriate for the United States to have such an assistance program for that country for reasons of human welfare considerations and for longer run political and development reasons. In such an instance, it may be that the right approach, maybe the only approach, is for the donor's import and counterpart program to operate as independently of the government's own organization and management as is possible. The United States would own the counterpart funds or, if not own in a legal sense, have complete control over their use and would use them in a manner decided upon by USAID. It is possible that, even in such troubled circumstances, a number of people will be helped, and, more importantly, some spillover effects might be realized in other parts of the private sector from suitably designed projects. The accumulation of counterpart funds would take place in the usual manner, and the donor would be completely responsible for finding uses for the funds. This situation may be looked upon as the opposite of that in which the donor simply agrees, more or less routinely, with the use of counterpart funds to finance some specific items in the development budget of a country with a strong bureaucracy with such extensive control over counterpart funds, the donor is making an essentially unilateral decision. Such an arrangement puts an even heavier burden on the donor to understand how the economy works, where it makes sense to try to take action, where there may be some spillover effect beyond the direct consequence of an activity, etc. Evidently, the recipient government can, if it so decides, prohibit the donor from functioning in this way. Although such an approach should not be entered into lightly, we do urge the view that heavy donor involvement can occasionally, be quite effective and should be recognized as a legitimate approach in certain circumstances.

The extreme case just referred to is not likely to be found often. To some extent the situation described in the previous paragraph represents the recipient government tying its hands, (possibly because the amounts involved are so small) agreeing that it must accept some limitations on its freedom to act in order to get the aid transfer. This is a version of the argument that we have made earlier, namely that one of the important reasons for a commodity aid/counterpart fund approach is that, in a given context, some loss of freedom on the part of the recipient government is necessary to achieve what is accepted as appropriate, even necessary for development. In some countries -- Zaire at the moment probably -- is just indifferent to the whole process. In allowing the donor to proceed with such independence, the government is (or may be) recognizing that it is presently incapable of doing what it knows an effective government should do. Caution is again called for, however, because of the difficulty of determining whether or not the government is simply currently not able to perform its role in an adequate manner or whether there exists a reasonable disagreement between the donor and the recipient on the use of the counterpart funds. In the latter instance the donor should not try to evade dealing with the recipient government.

The preceding argument is legitimate and important, and is highly relevant in a number of aid-receiving countries, (Liberia, Zaire, and Haiti in recent years for example) and rests on the recognition that many of the governments of less developed countries are inexperienced and ill-prepared to deal with new and complex issues. The temptation is great, therefore, for the donor to proceed to do everything itself "for" the aid recipient. In some cases this may be right, as we have just argued, especially when humanitarian issues are dominant. In most cases, however, for the donor to do everything for the recipient country (with respect to a project) defeats development as it eliminates important opportunities for the recipient to learn and accumulate experience. We conclude that the donor going it alone -- even with the genuine permission of the government -- should be limited to those situations where humanitarian considerations are strong and where spillover effects can be clearly discerned. In most instances, it is essential for the donor to work with the recipient country on the selection of commodities to be imported, the use of counterpart funds, their disbursement, etc. not only in the interest of harmony, but also because such joint efforts contribute to a long run learning process which itself is a major part of development.

B. Counterpart Funds Generated with Cash Transfers

As we noted when reviewing the data in earlier pages, cash transfers have greatly increased in recent years relative to commodity transfers and other forms of aid. This is true for USAID and seems to be the case for other donors as well. The preceding arguments about commodity transfers apply to cash transfers as well, so we can be fairly brief in this part.

A cash transfer means exactly that, the donor hands the recipient government a check in the currency of the donor, e.g. a US$ check. The recipient government uses the dollar check to buy local currency from the Central Bank. The local currency is then defined as counterpart funds owned by the government, and their use determined in consultation with the donor. The government could use its new resources to pay foreign debts, in which case there is no effect on the economy except that the foreign debt is reduced. The resources might also be used directly to import commodities. In this case there is an immediate increase in imports into the recipient country, and one would then explore the consequences of that fact as we did above.

There are several possible sequences of events. If the Central Bank adds the foreign exchange to its reserves, and does not allow it to be used, then the consequence is simply an increase in the local currency deposits available to the government. The government may spend these funds, and this spending will lead to an increase in the money supply. Whether such expenditures lead to inflation depends, as we saw above, on the state of the economy. Consider a country, for example, which has a strong balance of payments position, no inflation, and little unemployment or other idle resources. The country may, for historical, institutional, or other reasons, be unwilling or unable to run a deficit in the government budget. It may also be convinced that it is unwise to raise taxes. Clearly under these conditions, additional local currency is not forthcoming to the government, yet additional spending could have significant benefits. This situation was very much like that in Malaysia in the 1970s. (There was little aid to Malaysia in this period.) Perhaps Iran in the late 1950s was also in this position.

The aid in this instance provides some assurance that the increased expenditure by the government would not lead to inflation or to balance of payments troubles. If prices tend to rise, imports can increase to keep them stable. Thus the expansionary activities of the government could be accomplished with little fear of any destabilizing consequences. While such instances are doubtless infrequent, we emphasize that this is a perfectly good use of the aid and of the counterpart funds. They are in a real sense contributing to stability and to development. In those instances where imports do not increase, we note as well that having dollars (or other foreign currency) accumulate as foreign exchange reserves does not have the same adverse effects that we have seen obtain when the local currency funds pile up since it is no inflation threat and constitutes a clear hedge against balance of payments problems.

Other uses of cash grants could be cited, but in general they bring out no issues different from those we have discussed with respect to commodity aid. In fact, the above story could be told for commodity aid as well as cash transfers. We do note the obvious point that cash aid allows much greater freedom in the selection of imports, and this is usually an advantage.

In recent years the use of foreign aid to repay external debt has become a significant issue. Where such is the case and there is no corresponding generation of counterpart funds, then there is nothing more to say in a study of counterpart funds. There will be an effect of such use of aid on the economy -- the exchange rate will probably be affected for example -- but the study of such an effect is not within the terms of reference of the present paper.

It could be the case that aid for this purpose would require that the recipient country generate the appropriate amount of counterpart funds. We have found no instance of this being the case, but a comment or two on the consequences of such a procedure may help identify some further aspects of the counterpart fund process.

If aid is used to retire foreign debt then obviously it cannot be used to increase imports, so there can be no increase in the availability of goods and services in the economy relative to the situation before the aid. The government obviously cannot "generate" counterpart funds by the sale of any products. If counterpart funds are to be generated, then the government must increase taxes or borrow from the Central Bank or reduce expenditures below the level planned before the aid. If the economy was not experiencing inflation or balance of payments problems - was in a macro sustainable equilibrium -- then the objective should be to keep aggregate demand at the prevailing level. The best approach in this case would be to forget about the generation of counterpart funds. If this is not possible for administrative reasons, then USAID could simply identify some of the planned government expenditures as being from counterpart funds.

If the country is experiencing pure excess demand inflation, the requirement that counterpart funds be generated provides an opportunity for the recipient country, in cooperation with the donor, to take anti-inflationary measures. Such measures would be in the form of increased taxes or reduced government spending. The resulting funds would then be sterilized in some way or other. There are several reasons why increased taxes or reduced government spending might be possible after aid has become available to reduce external debt, but not before. The most obvious of such reasons is simply that the recipient government has a reason to offer to its various constituents as to why taxes are being raised or spending reduced. To the extent that "reasons" matter in such a situation, the government would appear to be in a strong position. Presumably also the donor government would have pushed the recipient government to commit itself to enacting anti-inflation measures before the aid was provided for external debt retirement. Evidently, much depends on the capacity of the government to commit itself to these purposes, and the fact that there is no automatic means by which the government increases its revenue (i.e. through the sale of aid provided commodities) makes the anti-inflation measures much more difficult to achieve.

A somewhat similar situation arises when the aid provided imports are used by the government itself rather than sold to the private sector. In this case the government acquires no revenue directly, but there is an increase in the availability of commodities in the economy. The government must then increase taxes, reduce expenditures, or borrow from the Central Bank to create the counterpart funds. The need to do any of these things would not arise if the government had included in its original budget the domestic funds to match the cost of the commodity aid. This is generally looked upon as a useful procedure. If this procedure were in fact followed, the next question would be whether or not to use the counterpart funds, and if they are to be used, in what way. The issues are no different in this case from what they were the previous ones that have already been discussed. Similarly, if the imported items were not included in the budget and the generation of counterpart funds was required, the various issues to be considered are as discussed in the preceding stories.

Chapter 7. Some Case Studies

In this section we consider a number of examples of the uses of counterpart funds by USAID. These examples are all taken from the reports prepared for USAID and made available to us. We begin with some general observations that will help to direct our attention to the key issues.

Our arguments have led us to place great emphasis on an approach to the use of counterpart funds that depends heavily on the AID Mission being able to look at the economy of the recipient country and determine whether and where such funds can be most effective. This is in contrast to an emphasis on rules or regulations that spell out in detail what the mission can do. As we have seen counterpart funds are peculiar in several ways, and it may, in some but not all cases, be useful to exploit that peculiarity. Equally important is the emphasis on continuing discussion with the officials of the recipient government. Where the recipient government is really convinced of the appropriateness of a policy, things are much more likely to work out well. Leverage is not a term that conveys the right idea, and our studies show that in those instances where AID has discussed and discussed and discussed with the recipient government, the policies associated with the aid and counterpart funds are better designed and better implemented. We have also found considerable agreement in the literature that control over counterpart funds as such adds very little to USAID's capacity to sway a recipient government. The enhanced recognition of the role of institutions, customs, politics in aid giving and aid receiving also means that the allocation of the counterpart funds is more likely to "fit" the country than where general rules are paramount. There is more trust and greater general appreciation of the constraints under which both donor and recipient necessarily function than is the case when leverage and conditionality appear to dominate discussions.

We have noted that much hinges on how development is presumed to take place. This point includes objectives of development as well as processes and mechanisms. One "advantage" of inflation and balance of payments difficulties and severe distortion in an economy is that their existence helps to identify specific objectives (eliminate them) on which agreement is, in general, widespread. All uses of counterpart funds are intended to contribute to the development of the recipient country, and how that can be done depends on how development can be induced in a particular country at a particular time. The state of understanding of how development takes place remains quite primitive of course, and it is dangerous indeed to rely heavily on a specific theory or principle independent of specific country context. Nothing can replace careful and continuing study of the specific country, and then acting on the results of that study. Such observations hold for all aid, of course, but are especially pertinent in the use of counterpart funds for the reasons noted in the previous paragraph, namely that they may, in some circumstances, provide unusual opportunities to do something especially strategic. Where that is not the case -- where they are used largely for conventional development projects, building roads, dams, schools, lending to small businesses, etc. -- the justification for their existence is considerably reduced.

In the following pages we hope to show where and how funds have been used especially well and why it seems to us that they were used extra well. We also discuss, more briefly, cases where it seems that the existence or use of counterpart funds has not contributed much.

1. Costa Rica: The Divesture Program of 'CODESA'

The use of counterpart funds in Costa Rica to effect the privatizing of certain government owned and operated firms is, perhaps, the most creative of uses that we have found in our survey. It is worth a careful summary. Our review is based on the report prepared by Alexander C. Tomlinson and Ismael Benavides of the Center for Privatization in May, 1988 and that of Robert Nathan Associates, 1987.

During the early years of the 1980s unusually large scale cash grants were provided to Costa Rica which in turn generated substantial amounts of counterpart funds. The government of Costa Rica, the IMF, and the USAID mission agreed that to spend such funds for the usual array of development projects would create major inflationary pressures. So the funds piled up. Their accumulation created the problems that have been noted: the continued threat and pressure to spend plus the political awkwardness created for both the Costa Rican government and the United States as a consequence of the latter having some control over such large amounts of the currency of Costa Rica.

At the same time it became evident to many observers that a major source of the government's financial difficulties arose from the fact that CODESA (Corporacion Constarricense de Desarrollo, S.A.) was losing large sums of money and was borrowing heavily from the Central Bank. CODESA had been founded in 1972, to fund and strengthen in other ways private sector enterprises, but it had been poorly managed and was in turn mismanaging its investments. Its borrowing from the Central Bank in 1983 accounted for one-third of the public sector credit, while it was generating minimal value added and virtually no employment.

In this context the USAID mission was able to discuss at some length and in considerable detail the advantages of modifying the CODESA arrangements in such a way that the firms under their control became essentially independent. This process was handicapped by the fact that CODESA owed large amounts of local currency to the Central Bank of Costa Rica. The arrangements were then made to use the counterpart funds to 'pay off' the debts of CODESA. This was largely a bookkeeping transaction that resulted in the writing off of the CODESA debts by 'debiting' the counterpart fund account. The latter then were effectively 'used,' the threat of their becoming inflationary was eliminated, and so too the awkwardness to the United States of their existence. There are numerous details in this use of counterpart funds, but we do not need to summarize them here. The main features can be listed as follows:

a) The careful way in which USAID in Costa Rica worked with the Costa Rican government was crucial. The governments became convinced of the appropriateness of the privatization strategy. This seems to have been a consequence of the careful and continuing efforts of the USAID mission to discuss the issues involved at considerable length.

b) The use of regular government funds in this way would have run into such major political problems that the project could not have been accomplished.

c) So far as we can tell from the reports, the idea of using counterpart funds in this way originated with USAID Costa Rica. The idea sprang from a great deal of knowledge and insight into the Costa Rican economy plus an understanding of the political and institutional arrangements of the country.

d) Similarly it required considerable flexibility and freedom at the mission level, as such a use could hardly be foreseen in the rules and regulations, etc. that ordinarily apply.

e) Finally, it does not seem to us that 'leverage' was applied in any way. Rather it was a joint effort emerging from discussion and from understanding the economics and the politics and institutions of the situation. We conclude that this project was exceedingly useful in achieving objectives considered desirable by the government and the USAID. It seems fairly clear that this could not have been accomplished without counterpart funds.

2. <u>Haiti: Counterpart Programming with a Helpless Government</u>

The USAID program in Haiti illustrates the value of the counterpart fund arrangement in a country where the government is unable or unwilling to do much of anything, but yet will allow USAID to conduct certain kinds of aid programs. This review is based on material in Alice Morton and Richard Newberg (1989). This report is mainly concerned with food aid, but the general arguments apply to other sources of counterpart funds.

The Haitian government has long been so unfortunate that it could not be looked upon as a partner or collaborator with USAID in the development of the country. Yet for both humanitarian and political reasons it was deemed important for the United States to keep an aid program in that country. Under these circumstances the role that the USAID had to play was much greater than it was in most other countries. USAID/Haiti conducted a wide range of studies that are reported to be of very high quality. The conduct of these studies was facilitated by the use of Haitian personnel both in and out of the government. Thus there was an informal cooperation between USAID and the Haitians that enabled the mission personnel to gain an understanding of a wide range of matters relevant to Haiti's history and the way things were done in that country. The issue does not seem to have been one of "leverage" or "conditionality." Rather it was one of gaining some confidence about what kinds of projects would be helpful in such a context and of understanding how to go about implementing them in the absence of a major effort by the government itself. The availability of the counterpart funds made such an approach possible. The report also emphasizes the importance of the mission having considerable freedom to act and to commit resources without too much delay or control from Washington.

Most of the local currency sales proceeds were programmed for the use of the mission's projects, so that the linkage between the Food for Development program and other USAID projects is close. Nevertheless difficulties with the program were rampant in a country with Haiti's characteristics. It seems clear that for USAID to try to establish an institutional arrangement that would have long run implications was to seek to do the impossible. Hence the objective should be (and we understand that in fact it was) to supply food aid and then, with the local currency proceeds, try to put in place some additional activities that would have favorable effects on agriculture. Any elaborate, long range development programs, any institution building, did not really make sense in the Haitian context of the 1980s. Yet it did make sense for AID to try to be present and to make some contribution to relieving the agony of the very poor. Aid assistance probably could not have been nearly as useful as it was, had the counterpart funds not been available. A similar story could be told about USAID's operation in Liberia in recent years.

3. Tunisia: Some General Lessons

The report on Tunisia and Mali (written by Newberry, Morton, and Harmon, (1985)) illustrates several other issues. This report emphasizes the desirability of multiyear commitments; the fact that the United States was unable to commit itself for more than one year was a disappointment to both the USAID mission and the Tunisian officials. It is especially useful in decisions about counterpart funds to be able to think in terms of several years. Apparently the mission staff was able to convince their Tunisian colleagues of their good intentions in this regard.

A second issue that emerges from the Tunisia case refers again to the matter of "leverage." The arguments in the report point up two things: the first is that the counterpart fund arrangement enabled the United States to "buy a seat at the table." The second is that things seem to work more smoothly when good rapport is established at the technical level before the formal negotiations among the policy makers begin. These arguments, we think, are of great importance.

The Tunisian evidence brings out the value of having good relationships established at the technical level before ambassadors and mission directors actually meet with the leaders of the recipient country's government to make a formal agreement. If the technical level discussions have gone well, then not only is there a more cordial atmosphere, but also it is less likely that ideology or other nationalistic matters will create difficulties. Note here too that the situation varies from country to country. In the Costa Rican divestiture example, it was crucial to the success of that effort that the mission director consult continuously with the Costa Rican president. So again we see that country context matters. The report on both Tunisia and Mali make clear the delicacy of trying to use influence over counterpart funds as a means of affecting the domestic policies of the aid receiving country. That is one of the several reasons why, to the extent possible, discussions should go as far as possible at the technical level before turning to the making of formal agreements between countries. This is of course true for all aid, but seems especially true when influence over broad policy matters is sought on the basis of some control over the use of counterpart funds. For example, in both Tunisia and Mali, USAID emphasized the effectiveness of an increased role for private enterprise, but did so largely in the context of addressing other, less sensitive, issues (Morton and Newberg, (1989), p 27). This illustrates the point made above: namely, mission personnel should go as far as possible with technical argument, argument that lends itself to reaching real agreement.

The report on Tunisia and Mali (Morton and Newberg, (1989), p. 28-29) makes another point about leverage. It notes that in both countries negotiations have taken into account each country's economic and political constraints, and have tried to work within them rather than simply harassing the government to make changes that are essentially impossible to make at a given time. What the counterpart funds in these two countries did was to enable USAID to have an opportunity to be part of the discussions on policy. It may be noted as well that such an arrangement helps USAID determine the extent of the effort and commitment by the aid receiving government, and that, in most instances, is more important than meeting some specified target.

4. <u>Madagascar: Identification of Constraints</u>

One important general point that emerges from the study of Madagascar by James E. Hawes (1987) has to do with the role of the identification of constraints to development. It is noted that in the early 1980s the majority of the counterpart funds in Madagascar was used to rehabilitate irrigation, village potable water systems, and transport infrastructure. None of these, Hawes argues, constituted a significant constraint on the increase in agricultural production, the main objective of the program. There is little doubt that in many countries counterpart funds are in fact used in a way that does not push back a constraint that is currently operative, and hence has no immediate effect, and possibly no long run effect. Hawes argues that funds used to support IRRI Grant Rice Research Project had the greatest impact.

We have no way of evaluating his position, but the general point is well worth emphasizing. (We should note that other material on Madagascar indicates that irrigation was especially valuable for increasing output.) The only way that one can determine whether a specific characteristic of an economy is in fact a current bottleneck is from a thorough knowledge of how the economy (including the political economy) of the country works. To find the real barrier and act on it, or to act on something that may affect the real barrier, requires insight and understanding, but is necessary for an effective use of any development expenditure including counterpart funds. The fact that counterpart funds can often be used quickly, without lengthy legislative action, is an advantage that can be exploited only if this knowledge exists. Our reading of the various reports turned up few examples where the use of counterpart funds to finance the construction of infrastructure and other conventional development projects seemed to constitute a use of counterpart funds that justified the costs and other problems associated with the arrangement. Such a statement is of course quite subjective as studies weighing costs and benefits of the uses of counterpart funds are not available, but the point just made does seem to us to be generally valid. One should add, of course, that the real bottlenecks may be immune from any action made possible by the availability of counterpart funds. For counterpart funds to be useful in these circumstances, they must allow something to take place that could not or would not take place without them.

5. <u>Pakistan: Perhaps Counterpart Funds are NOT Necessary</u>

The United States has provided aid to Pakistan for many years and in many forms. Several reports indicate that relations between USAID personnel and Pakistani civil servants have been strong and effective. The large amount of counterpart funds that have been generated by food and other aid have sometimes caused difficulties for the reasons that have been noted above. For this reason and because the Pakistani development planning process is well respected, the practice of allowing counterpart funds to be used for regular items in the development budget is surely the appropriate procedure. Evidence in the reports along with other evidence suggests that influence of USAID officials is not enhanced much by the counterpart funds arrangements. To eliminate counterpart funds in the case of Pakistan would, in our view, have little effect, and might actually enhance the positions of USAID personnel in discussions with the Pakistani officials by making it clear that USAID itself was flexible and respected the integrity of the Pakistani development effort.

On the other hand, there is convincing evidence that the USAID was in fact able to persuade the Pakistani government to commit an amount of real resources to health and education activities above what it had previously planned over the next decade. This was achieved, it seems, by virtue of the continuing role of USAID personnel in the discussion of development issues with the Pakistani authorities as well as U.S. commitments to continued aid transfers. And the counterpart fund arrangement may well facilitate the Pakistani government living up to its commitments. The commitments will benefit two of the poorer regions, and having the funds in separate accounts may make it easier for the central government to avoid lobbying for alternative uses of resources.

6. <u>Counterpart Funds in Kenya: In Some Situations, Counterpart Funds are Left Unspent</u>

The "Audit of Local Currency Programming in Kenya" (1987) lends support to those who argue that the transfer of the aid does imply some influence on resource allocation, but that counterpart funds does not add much influence. The audit states that counterpart proceeds "were not being programmed or expended in a timely manner." The audit recommended no new agreements until the Government of Kenya and USAID agreed on how all accumulated counterpart funds would be used. The method for influencing resource allocation here is clearly the threat of withholding future aid transfers, although everyone recognizes that to do so in the case of food aid is extremely difficult. It is equally clear that the existence of the counterpart funds had little influence on resource allocation decisions.

The counterpart funds were not "spent" because the Government of Kenya and USAID disagreed on how to use them. The Government of Kenya wanted to use the counterpart funds for general budgetary attributions. Since USAID did not go along, presumably it had a problem with the resource allocation implicit in that budget. In this situation, it is not clear whether counterpart funds can or should change the Government of Kenya's allocation decisions.

The audit report raises one final interesting point. Despite the fact that it is generally agreed that the counterpart funds are not additional real resources to the economy as a whole, the following quote demonstrates how this issue is sometimes confused:

> The delays in programming created delays in the use of the proceeds. During these delays, inflation in Kenya constantly eroded the purchasing power of the proceeds. Based on an examination of the cash flow associated with four agreements, the purchasing power of $23.8 million had declined to $17.7 million, a loss of $6.1 million. More importantly, this meant that the products or services which the $6.1 million could have purchased to support Kenya's development would not be obtained. ((1987), p. 6.)

It is not necessarily the case that $6.1 million in spending on development was forgone. For example, the Kenyan government might have chosen not to use the counterpart funds and instead borrow from the Central Bank an equal amount to finance development expenditures. In this case, USAID's influence on resource allocation declined by this much, assuming every real dollar programmed counts as a dollar influenced. The decline in the value of the counterpart funds represents a decline in the claims of the government on resources (which may or may not be offset by other claims), but it does not represent a reduction in resources to the economy as a whole that can be used for development purposes.

7. Mozambique and Dominican Republic: Stabilization versus Resource Allocation

In 1987, the government of Mozambique adopted a stabilization program, the Economic Rehabilitation Program (ERP). The policy measures include "adherence to strict fiscal and monetary policies under the auspices of the IMF and IBRD." The use of counterpart funds is constrained by the IMF targets for the government budget and the money supply. The USAID mission believed its use of counterpart funds should support the IMF program. It therefore believed that stabilizing the country was a necessary, if not sufficient, condition for improved growth in Mozambique.

The counterpart funds were to be used to finance part of the government deficit. Since the monetary effects of financing the deficit were already in the monetary program, uses of the counterpart funds are included in the monetary targets. (The only way spending the counterpart funds would contribute to violating the credit targets would be if spending increased above previously planned levels, and therefore the deficit increased, and this increase was financed by additional counterpart funds.)

The counterpart funds was allocated "for attribution" to the areas in the budget consistent with AID objectives. Under the economic conditions in Mozambique, not uncommon in developing countries, the aid and counterpart funds are contributing to stabilization by easing the balance of payments constraint and increasing resources available to the government. If the donor agrees with the IMF/IBRD goals, then in programming the counterpart funds, these goals should be supported. A major mistake would be to program counterpart funds accumulated in previous years, on expenditures not in the government budget agreed to in the stabilization program. This would increase the deficit and domestic credit to the government and violate the monetary targets. Less clear is whether the donor should attempt to influence the allocation of resources within the given level of government expenditures agreed to in the stabilization program. The IMF worries that protecting certain categories of expenditures within a constrained total level of spending will lead to a skewed, not better, allocation of resources. By programming the counterpart funds "for attribution", USAID is not having much, if any, effect on resource allocation through the counterpart funds mechanism as such; USAID did have some role in the determination of the size and allocation of the government budget.

This example raises an issue about when agreement should be reached on how the counterpart funds should be programmed. It is often argued that agreement should be reached when the aid is transferred. The argument is that this is the point at which the donor is in the strongest position. But if this is done, and then economic circumstances change, for example a stabilization program is adopted, the agreement reached on counterpart funds spending may not coincide with stabilization goals. In cases like this, the USAID mission should be flexible about agreements previously reached.

The AID program in the Dominican Republic is a slight variation of the Mozambique story. A major component of the AID strategy (1986/87) was "sustained implementation of the economic stabilization program" (p.40). At the same time, the Aid Evaluation (November 1988) states that "the joint programming agreement permits the United States to maximize its (counterpart funds) use for AID program objectives and to apply conditionality effectively." The types of programs for which the counterpart funds are programmed are examined and the stabilization program includes constraints on domestic credit. Any counterpart funds programmed contributes to the domestic credit target. Therefore, in contrast to Mozambique, USAID has attempted to influence the allocation of resources in the overall budget, and has not simply programmed counterpart funds "for attribution." It is not clear why this decision was made in the case of Dominican Republic and not Mozambique and whether there were benefits to doing this.

The Mozambique and Dominican Republic cases demonstrate that the aid plus counterpart funds mechanism can contribute to development by facilitating macrostabilization. The Dominican Republic story suggests that in some cases it may be possible to contribute to stabilization, and within the government budget consistent with stabilization, have some influence on allocation decisions. It should be kept in mind, however, that if stabilization is a primary concern, then it should not be sacrificed to influence resource allocation.

The "FY 1985 Evaluation of the Bangladesh Program" (p.35) notes the following points:

> ...the importance of policy dialogue, however imprecise and non-quantifiable it may sometimes be, can in many instances be paramount over discreet matters as how many miles of canal are built here, or what number of pumps have been placed in operation there, or was the accounting of that activity up to developed countries' standards?
>
> As a matter of sovereign pride, developing country governments feel they can accept only so much "guidance" in return for a given level of assistance, so it follows that increased US government intervention in their affairs in areas of minor objective importance may result in diminished ability to influence them in areas that are truly critical.

The stabilization issue is one example of this. If considered vital, aid and counterpart funds should be used in a way that supports the stabilization goal. If control over allocation decisions has to be given up in order that the aid and counterpart funds contribute to stabilization, this will still be the most effective use that is possible in the circumstances.

8. Jamaica: Confusion Regarding Monetary Effects

The evaluation of the cash transfer program in Jamaica (Jamaica: Cash Transfer Evaluation, January 1988) illustrates the difficulty in getting the monetary effects of counterpart funds completely correct.

> When cash transfer dollars are provided to the GOJ they can be used to finance imports, pay debt arrears, or added to foreign exchange reserves. No matter which use is chosen, an equivalent amount of local currency will be created. If the dollars are applied to debt repayment or added to foreign exchange reserves, there will be no immediate increase in imports but there will initially be an increase in local currency. With an increase in the money supply and no increase in the availability of goods, the effect will be inflationary in the near term. The GOJ creates additional local currency but no additional goods are available. If, on the other hand, the AID cash transfer is used to finance imports, there is an increase in imported goods and an equivalent amount of local currency withdrawn from the economy. There is no inflationary impact. In the longer term, the inflationary impact of a given cash transfer is likely to be neutralized. Even if the dollars are not used for imports in the near term, they presumably will be eventually (since either debt repayment or additions to reserves bolster a country's import capacity). The effect, therefore, is likely to be one of leads and lags: initially inflationary, later deflationary. (p.76)

This statement is not quite complete. Counterpart funds are government deposits at the Central Bank. When the government receives a cash transfer, counterpart funds are generated when it sells the foreign exchange to the Central Bank or the private sector. In the former case, the money supply is initially left unchanged. If instead the government sells the foreign exchange to the private sector, high powered money declines. As discussed earlier (Chapter 5, Section 2), however, to determine the final effect of the aid and counterpart funds on the money supply, the effects on the balance of payments and the government budget must be analyzed. Assume, in Jamaica's case, that the government deficit does not increase as a result of the aid (the initial levels of expenditures and taxes remain unchanged). Assume further that the government has generated the counterpart funds by selling the foreign exchange to the Central Bank. Initially, there is no effect on the money supply, and the amount of borrowing from the Central Bank required to finance the government deficit remains unchanged. If imports increase from what they would have otherwise been, net foreign assets at the Central Bank will decrease, decreasing high powered money and the money supply. If imports remain constant, then nothing changes. In the Jamaican study, the monetary effects as described above are not completely worked out, either on impact or after the balance of payments or government deficit effects are incorporated.

This example is a useful one for showing that the initial effect of the counterpart funds on the money supply can result in confusion about the final or total monetary effects of counterpart funds. As mentioned above, on impact, the monetary effect differs if the government sells the foreign exchange to the private sector rather than the Central Bank. But, ultimately, this is irrelevant. To see this, if imports do not increase from previous levels, the private sector has no use for the foreign exchange. Purchases of foreign exchange that otherwise would have taken place, will now not be needed. Net foreign assets at the Central Bank will be higher by this amount. The effect of this (which increases high powered money from what it otherwise would have been) plus the impact effect (which reduces the high powered money) leave the money supply unchanged. This is the same final effect on the money supply if the aid is sold to the Central Bank in the first place and imports do not increase.

9. Egypt: Where Political Considerations Dominate

Egypt is perhaps the most unambiguous example of an aid program that is dominated by political considerations. In some other countries, political and strategic factors matter, and matter greatly, but it seems that in Egypt, such factors are much more important than development or stabilization concerns. In this context, it is very difficult for USAID to have any role at all in influencing policy. The very fact that it is known that aid will be forthcoming eliminates any claim on the attention of the Egyptian policy maker's by the donor. More fundamentally, it creates the impression that the United States is not really interested in the country's development. Thus the USAID personnel have to be extra good, extra imaginative to get a hearing at all. Counterpart funds in this kind of environment are a net cost with no redeeming benefits.

It has been noted that in the sort of circumstance that Egypt represents, the use of counterpart funds -- especially if fully owned by the United States -- through private sector activities might be especially effective. In Egypt some counterpart funds were provided to the

American University of Cairo, a fairly effective institution. Doubtless other similar uses might be found. Such arrangements obviously complicate the task of insuring that their use is not destabilizing. If the counterpart funds are not owned by the United States, the recipient government must also give its approval which might add further complexity.

Chapter 8: Conclusions

We conclude that the effectiveness of the counterpart fund mechanism depends heavily on the circumstances in the country at the particular time. We have found that this mechanism may increase the money supply (it may also decrease the money supply). It may affect the allocation of resources within the government budget. It may affect the allocation of resources between the public and private sectors. It may affect the choice of policies of the government.

We have argued that whether the counterpart fund mechanism has a particular effect depends on the particular country circumstances. Much more importantly, we have argued that whether it is a good thing that the counterpart fund mechanism has any particular effect also depends on the particular country circumstances. By good, we mean that the mechanism contributes to development. We certainly argue that some particular effect of counterpart funds, such as reducing the money supply, may be beneficial in some circumstances but not in others.

In general, we have assumed that if there is a government objective with which USAID agrees, (or a USAID objective with which the government agrees) then it is desirable for counterpart funds to be used to achieve this objective. For example, if both the government and USAID agree that additional resources should be channelled to the private sector, and counterpart funds can be used to help accomplish this, then using counterpart funds this way is useful. But we would certainly not conclude that counterpart funds should be used in all countries at all times to reallocate resources to the private sector.

If government and USAID objectives differ, then the question of what contributes to development becomes more problematic. If the government's objectives are clearly not related to development, then there is less of a problem. Anything that USAID can do, that the government does not prevent, will hopefully be an improvement over doing nothing. As discussed above, counterpart funds may help here by keeping aid resources out of government coffers.

Where the government and USAID disagree over how best to promote development, we are less comfortable with the role of the counterpart funds mechanism. In many such circumstances, the government can act in such a way that the counterpart funds have little or no effects. The donor can attempt to impose its views, but we have argued that the counterpart funds probably play little to no role in the success of such an effort. The real stick or carrot is the transfer of the real aid, the commodities or the cash, not the counterpart funds. Control over the counterpart funds will not help resolve this situation. The counterpart funds may play a role here if their existence leads to continued discussion between donor and recipient, so that some enhanced understanding of development is achieved by both donor and recipient. Although this issue is really separate from the counterpart funds debate, we would argue against the donor imposing or seeking to impose its views on recipients.

All of this means that there ought not to be one set of specific policies relating to counterpart funds that the donor should follow. They should not always be used to reduce the money supply. They should not always be used to transfer resources to the private sector. They should not always be owned either by the donor or by the recipient. The best use of counterpart funds will depend on the particular circumstances in the recipient country at that point in time. And the best use of counterpart funds should be decided on by the government of the recipient and donors knowledgeable about the country's circumstances. Generating understanding, not exercising leverage, should be the donor's goal in the use of counterpart funds.

For the use of counterpart funds to be beneficial and worth the sometimes considerable costs of management skills and the possibility of creating ill will between the United States and the recipient country, there need be flexibility and responsiveness in Mission procedure. Given this, there must be the capacity to identify where the particular bottlenecks or barriers to development are and how the use of counterpart funds might help overcome or go around them. In the numerous reports of counterpart funds uses that we studied, we found examples that seemed to us to be imaginative and effective. At the same time we also saw fewer examples of the use of counterpart funds that contributed to what we regard as the real basis of development.

Our conclusions are consistent with several aspects of current AID policy on counterpart funds ("AID Local Currency Policy," Memorandum for Executive Staff from the Administrator, 9/90). This policy does not require that counterpart funds be generated in all countries -- only when required by statute or when desired by the mission. This recognizes that in some situations, counterpart funds may serve no useful purpose or worse, only impose costs. Placing the decision with the mission recognizes that a good deal of country knowledge will be required to determine the usefulness of the counterpart fund mechanism. Current policy "explicitly permits missions to jointly program local currency to help fund a government's deficit." This has always been a possibility, if counterpart funds were used for items in the budget and government spending and revenues remained unchanged. This policy recognizes more explicitly that development objectives may be most productively pursued by contributing to stabilization, as opposed to more directly affecting resource allocation.

Current AID policy also "imposes more rigorous accountability standards for managing local currency." This paper has not explicitly addressed this issued. Presumably more rigorous standards implies greater costs. From our work, it does not appear that more rigorous accounting standards will increase the benefits of generating and programming counterpart funds. This suggests that there will be fewer instances where it will be on net useful to use the counterpart fund mechanism. AID's greater flexibility in terms when counterpart funds are necessary may in part reflect this.

In an ideal world, it would be possible to do a cost benefit analysis of the use of counterpart funds in each country to determine whether AID should use them or not. Many of the costs and benefits are almost impossible to quantify, making such an approach unlikely to be productive. What kind of value could one place on creating ill-will between recipient and donor, on successfully reducing the money supply or the government budget deficit in line with stabilization objectives, on increasing resources available to the private sector or a NGO, on helping the government privatize parastatals. A more realistic approach may be to try to minimize the costs of using counterpart funds, while using them for purposes considered valuable by both the recipient country and the donor. When net benefits are zero or less, presumably the recipient government will leave them unspent.

We note, finally, one important result of our efforts with the data. There are very few instances where there can be real reason to believe that the counterpart funds process has been destabilizing and inflationary. We conclude, in general, that this concern, so frequently discussed in the literature, is rarely important. In fact the arguments described above (especially in Chapter

6) plus the data suggest that the aid plus counterpart funds approach has more often had a deflationary effect than an inflationary one. We emphasize that the data are incomplete and open to question. A more detailed study of the data would be enlightening on this issue. Even if incomplete and understated, the existing data have been underutilized in the existing literature.

[redacted]

TABLE 1: USAID DATA ON CF FOR SIX MAJOR AID RECIPIENTS

FISCAL YEAR 1988 ACTIVITY, THRU SEPTEMBER, 1988

COUNTRY	UNEXPENDED BALANCE Sept. 30, 1987 FC Units	$ Equiv.	Deposits FC	Deposits $	Disbursements FC	Disbursements $	Loss or Gain by Exchange	Unexpended Balance FC	Unexpended Balance $	Reserve Money(3) FC	Government Expenditure(2) FC
BAGLADESH (31.93 Taka per $1)										51021000	50482000 (1)
Country Owned	76	2	9137	293	8364	266	-2	849	27		
PAKISTAN (18.22 Rupees per $ 1)										113734000	159903000
U.S. Owned	178490	10234	-9415	-539	60536	3464	-274	108539	5957		
Country Owned	64405	3693	154839	8856	138625	7925	-199	80619	4425		
Total			145424		199161			189158			
PHILIPPINES (21.12 Pesos to $ 1)										72230000	125940000
Country Owned	147615	7219	139170	6636	134350	6398	-239	152435	7218		
EGYPT (2.318 Pounds per $ 1)										19476000	22227000
U.S. Owned	1075	493	...	...	-4	-1	-29	1079	465		
Country Owned	642250	294205	500509	224220	682609	301949	-17964	460150	198512		
Total			500509		682605			461229			
SUDAN (4.450 pounds per $ 1)										9447600	N.A.
U.S. Owned	21	8	...	...	...	...	-3	21	5		
Country Owned	637804	272244	488686	109817	204811	46405	-120447	957679	215209		
Total			488686		204811			957700			
EL SALVADOR (5.00 Colones per $1)										3011000	2723100 (4)
Country Owned	22288	4457	422	85	26672	5334	...	-3962	-792		

Note: All figures are rounded to thousands.
Source: USAID, STATUS OF FOREIGN CURRENCY FUNDS, 9/88.
1. 1985, last available data.
2. IMF, IFS, line 82.
3. IMF, IFS, line 14.
4. 1986, last available data.

TABLE 2: USAID DATA ON COUNTERPART FUNDS
(Importance Relative to Reserve Money and Government Spending)

RESERVE MONEY

	Deposits Reserve Money	Deposits-Disbursements Reserve Money	Unexpended Balances Reserve Money
Bangladesh	.01%	.00	.00
Pakistan	1.3%	-.5%	1.7%
Philippines	.2%	.00	.2%
Egypt	2.6%	-.9%	2.4%
Sudan	5.2%	3.0%	10.1%
El Salvador	.01%	-.9%	-*

GOVERNMENT SPENDING

	Deposits Government Spending	Disbursements Government Spending	Unexpended Balances Government Spending
Bangladesh	.01%	.02%	.00
Pakistan	.9%	.7%	1.2%
Philippines	.1%	1.1%	.1%
Egypt	2.3%	3.1%	2.1%
Sudan	NA	NA	NA
El Salvador	.01%	1.0%	*

* - Unexpended Balances Negative
NA - not available
.00 - zero when rounded to two decimal places

TABLE 3: COUNTERPART FUNDS: DATA AVAILIABLE FROM THE IMF

AFRICA:

1. Kenya: 16e........ 1985-1988
   36e........ 1985-1988

2. Madagascar: 16e........ 1979-1988

3. Morocco: 26e........ 1967-1984

4. Rwanda: 16e........ 1966-1988

5. Tunisia: 16e........ 1962-1986, 1988
   36e........ 1958-1986, 1988

6. Zaire: 16e........ 1963-1988
   36e........ 1963-1988

WESTERN HEMISPHERE:

1. Dominican Republic: 16e........ 1962-1988

2. El Salvador: 16e........ 1982-1988
   36e........ 1982-1988

3. Paraguay: 16e........ 1961-1988
   36e........ 1961-1988

ASIA:

1. Indonesia: 16e........ 1968-1988

2. Pakistan: 16e........ 1955-1988
   26e........ 1961-1988
   36e........ 1955-1988

Definitions: 16e.... Monetary Authorities Counterpart Funds
26e.... Money Banks Counterpart Funds
36e.... Monetary Survey Counterpart Funds (16e + 26e)

* Data gotten from the International Monetary Fund, International Financial Statistic (IFS) tapes.

DOMINICAN REPUBLIC

Table 4: Decomposition of Changes in the Monetary Base

Year	(1) % Change Monetary Base	(2) Of which is due to CF	(3) Of which is due to net Govt	(4) Other (1-2-3)
1948				
1949	8.51			
1950	15.29		-3.92	
1951	33.67		9.18	
1952	14.50		-6.36	
1953	-0.44		-17.78	
1954	27.01		-42.86	
1955	2.64		-3.51	
1956	4.79		1.03	
1957	14.38		-15.52	
1958	6.14		38.14	
1959	-4.71		41.99	
1960	17.94		-5.51	
1961	-11.26		14.85	
1962	17.68		8.50	
1963	20.99	-5.39	44.95	-18.58
1964	-4.45	4.83	-12.51	3.22
1965	26.19	-5.95	-18.35	50.50
1966	-7.86	-0.08	17.45	-25.24
1967	0.08	-0.61	17.34	-16.66
1968	17.58	-7.61	0.66	24.54
1969	17.08	-4.02	12.45	8.65
1970	12.02	5.47	6.29	0.25
1971	16.62	3.16	7.23	6.24
1972	8.69	-1.79	12.12	-1.63
1973	25.61	-3.11	-0.50	29.23
1974	46.46	5.72	12.65	28.10
1975	-7.82	0.06	-1.68	-6.21
1976	0.24	-0.10	-10.73	11.08
1977	28.20	-0.13	-24.08	52.41
1978	8.41	-0.34	9.42	-0.67
1979	8.42	-0.41	10.77	-1.94
1980	-3.65	-0.69	2.66	-5.62
1981	25.96	0.67	15.11	10.19
1982	2.51	-0.18	48.21	-45.52
1983	16.30	-3.12	22.08	-2.67
1984	29.09	3.34	-36.05	61.80
1985	-1.07	-5.97	-5.82	10.72
1986	94.59	1.57	-45.83	138.84
1987	-6.11	-19.53	16.51	-3.08
1988	103.13	17.77	-13.31	98.67

Source: IMF, IFS tape.

Notes: $\Delta H/H = -\Delta CF/H +$ (Δdifference betw. claims on govt & govt deposits/H)+ Other

H = 14, CF = 16e, net govt = 12a - 16d.

EL SALVADOR

Table 4: Decomposition of Changes in the Monetary Base

Year	(1) % Change Monetary Base	(2) Of which is due to CF	(3) Of which is due to net Govt	(4) Other (1-2-3)
1948				
1949	16.02			
1950	16.57			
1951	-75.02			
1952	20.95			
1953	-8.82		-249.67	
1954	-3.23		-24.73	
1955	19.63		-178.52	
1956	8.36		-171.83	
1957	-2.00		-502.00	
1958	5.54		508.16	
1959	10.22		111.33	
1960	-7.02		-144.36	
1961	-26.95		265.50	
1962	3[illegible].58		-1080.81	
1963	31.77		142.82	
1964	6.71		-76.94	
1965	50.10		-134.77	
1966	6.02		-220.03	
1967	44.32		78.64	
1968	15.31		39.09	
1969	4.38		3.71	
1970	5.69		-92.18	
1971	11.43		-63.75	
1972	26.07		-33.13	
1973	14.55		-125.51	
1974	15.55		-220.98	
1975	27.67		-75.55	
1976	34.82		-12.86	
1977	5.84		-649.63	
1978	-23.39		-1344.27	
1979	-7.57		-1711.19	
1980	28.09		-468.29	
1981	17.62		2753.56	
1982	169.30		655.60	
1983	3.97	3.61	21.54	-21.19
1984	11.54	0.00	-19.35	30.89
1985	22.60	-8.94	-180.71	212.25
1986	0.87	-4.86	-224.95	230.68
1987	25.01	-40.86	-471.63	537.50
1988	16.03	-4.46	-979.50	999.99

Source: IMF, IFS tape.

Notes: H/H = - CF/H+ (difference betw. claims on govt & govt deposits/H)+ Other

H = 14, CF = 16e, net govt = 12a - 16d.

PAKISTAN

Table 4: Decomposition of Changes in the Monetary Base

Year	(1) % Change Monetary Base	(2) Of which is due to CF	(3) Of which is due to net Govt	(4) Other (1-2-3)
1948				
1949				
1950				
1951				
1952				
1953				
1954				
1955				
1956	15.37	-8.97		
1957	5.14	-8.50		
1958	3.15	-1.71		
1959	2.08	1.34		
1960	9.36	1.17		
1961	-3.16	-6.85		
1962	2.96	3.99		
1963	11.57	-2.07		
1964	12.29	-0.02	1.40	10.91
1965	13.86	-2.01	13.88	1.99
1966	14.16	0.73	15.36	-1.94
1967	0.23	0.45	1.56	-1.78
1968	5.63	-1.13	-0.78	7.54
1969	10.36	4.16	16.83	-10.64
1970	11.46	-1.62	11.07	2.00
1971	10.85	-1.11	18.43	-6.46
1972	17.40	-0.99	10.51	7.88
1973	11.96	-2.00	-6.56	20.53
1974	0.69	-1.62	-6.29	8.59
1975	9.82	-0.89	24.10	-13.39
1976	19.78	0.34	8.60	10.84
1977	22.70	-1.74	32.54	-8.09
1978	17.57	1.05	23.76	-7.24
1979	26.74	-1.56	26.80	1.50
1980	16.66	-0.02	8.47	8.21
1981	8.20	0.53	10.80	-3.13
1982	17.68	0.86	21.74	-4.93
1983	13.76	-0.46	5.87	8.35
1984	16.37	0.96	26.96	-11.56
1985	8.62	0.40	4.88	3.33
1986	19.81	0.49	18.54	0.78
1987	19.47	0.31	10.93	8.24
1988	10.83	-0.05	-4.85	15.72

Source: IMF, IFS tape.

Notes: H/H = - CF/H+ (difference betw. claims on govt & govt deposits/H)+ Other
H = 14, CF = 16e, net govt = 12a - 16d.

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INDONESIA

Table 4: Decomposition of Changes in the Monetary Base

Year	(1) % Change Monetary Base	(2) Of which is due to CF	(3) Of which is due to net Govt	(4) Other (1-2-3)
1948				
1949				
1950				
1951				
1952				
1953				
1954				
1955				
1956				
1957				
1958				
1959				
1960				
1961				
1962				
1963				
1964				
1965				
1966	612.00		5104.00	
1967	155.06		-87.08	
1968	120.04		101.76	
1969	60.06	-8.61	-912.21	980.88
1970	29.58	6.38	329.64	-306.44
1971	28.76	3.62	13.37	11.78
1972	45.80	5.73	-64.17	104.24
1973	39.36	2.31	10.21	26.84
1974	56.87	-2.80	55.65	4.02
1975	33.16	-0.04	48.31	-15.11
1976	21.83	-3.82	-29.48	55.13
1977	24.67	-1.15	-5.12	30.94
1978	9.62	0.09	22.34	-12.81
1979	31.43	-1.55	5.27	27.71
1980	36.21	0.69	3.53	31.99
1981	16.15	1.84	-183.88	198.19
1982	4.76	0.28	25.86	-21.39
1983	25.12	-1.04	-173.36	199.53
1984	10.94	-3.18	112.84	-98.72
1985	17.91	1.05	12.77	4.09
1986	21.56	0.27	-126.98	148.27
1987	10.54	0.85	-42.89	52.59
1988	-7.20	0.62	54.52	-62.34

Source: IMF, IFS tape.

Notes: H/H = - CF/H+ (difference betw. claims on govt & govt deposits/H)+ Other
H = 14, CF = 16e, net govt = 12a - 16d.

PARAGUAY

Table 4: Decomposition of Changes in the Monetary Base

Year	(1) % Change Monetary Base	(2) Of which is due to CF	(3) Of which is due to net Govt	(4) Other (1-2-3)
1948				
1949				
1950				
1951				
1952				
1953	48.43			
1954	9.81			
1955	33.33			
1956	34.78			
1957	10.01			
1958	14.17			
1959	6.15			
1960	4.84			
1961	33.27			
1962	5.88	-13.49		
1963	21.74	-10.26		
1964	23.68	-2.35		
1965	14.26	-9.03		
1966	3.76	3.80		
1967	37.09	2.70	12.57	21.82
1968	-8.40	2.90	1.26	-12.56
1969	11.42	1.05	-1.96	12.33
1970	17.39	0.81	0.64	15.95
1971	12.88	0.06	4.59	8.23
1972	21.87	-0.83	10.38	12.32
1973	27.02	4.25	1.71	21.06
1974	17.67	0.46	-8.97	26.17
1975	22.86	0.04	-1.38	24.20
1976	20.75	-0.00	-2.18	22.93
1977	31.36	0.00	0.11	31.25
1978	33.10	0.01	3.10	29.99
1979	22.39	0.00	-1.12	23.50
1980	27.47	0.00	-3.11	30.58
1981	17.68	0.00	-2.66	20.34
1982	0.60	0.00	-1.72	2.32
1983	31.01	0.00	19.63	11.38
1984	17.11	0.00	5.19	11.91
1985	18.94	-0.00	2.62	16.33
1986	35.25	0.00	3.13	32.13
1987	40.25	0.00	5.33	34.92
1988	22.69	0.00	3.36	19.33

Source: IMF, IFS tape.

Notes: H/H = - CF/H+ (difference betw. claims on govt & govt deposits/H)+ Other

H = 14, CF = 16e, net govt = 12a - 16d.

KENYA

Table 4: Decomposition of Changes in the Monetary Base

Year	(1) % Change Monetary Base	(2) Of which is due to CF	(3) Of which is due to net Govt	(4) Other (1-2-3)
1948				
1949				
1950				
1951				
1952				
1953				
1954				
1955				
1956				
1957				
1958				
1959				
1960				
1961				
1962				
1963				
1964				
1965				
1966				
1967	27.35		-0.64	
1968	25.80		3.38	
1969	42.80		-5.85	
1970	11.33		3.46	
1971	-8.41		6.45	
1972	10.59		3.40	
1973	10.36		13.83	
1974	28.24		20.95	
1975	-9.84		28.51	
1976	24.05		-20.95	
1977	61.57		18.41	
1978	7.21		12.56	
1979	24.78		3.88	
1980	2.24		20.62	
1981	4.14		51.57	
1982	25.67		81.01	
1983	-2.21		-29.91	
1984	11.40		0.14	
1985	15.12		27.54	
1986	39.62	0.01	31.65	7.95
1987	19.35	-0.05	30.60	-11.19
1988	2.06	-0.07	3.52	-1.40

Source: IMF, IFS tape.

Notes: H/H = - CF/H+ (difference betw. claims on govt & govt deposits/H)+ Other
H = 14, CF = 16e, net govt = 12a - 16d.

ZAIRE

Table 4: Decomposition of Changes in the Monetary Base

Year	(1) % Change Monetary Base	(2) Of which is due to CF	(3) Of which is due to net Govt	(4) Other (1-2-3)
1948				
1949				
1950				
1951				
1952				
1953				
1954				
1955				
1956				
1957				
1958				
1959				
1960				
1961				
1962				
1963				
1964	15.63	-6.25		
1965	37.84	0.00		
1966	11.76	-1.96		
1967	36.84	-3.51	92.98	-52.63
1968	41.03	1.28	20.51	19.23
1969	11.82	-0.91	-26.36	39.09
1970	16.26	1.63	-120.33	134.96
1971	-13.29	-0.70	68.53	-81.12
1972	26.61	1.61	-19.35	44.35
1973	17.20	0.64	-39.49	56.05
1974	21.74	1.09	229.89	-209.24
1975	40.63	0.00	68.30	-27.68
1976	82.86	-1.27	87.30	-3.17
1977	28.82	-1.39	-146.18	176.39
1978	56.20	-1.62	270.89	-213.07
1979	-18.21	-1.04	53.67	-70.84
1980	114.14	3.69	36.71	73.73
1981	59.36	-0.30	85.12	-25.47
1982	91.87	-0.31	146.03	-53.85
1983	61.46	-5.75	56.29	10.92
1984	56.26	1.26	172.58	-117.58
1985	27.71	-1.19	108.58	-79.68
1986	60.56	1.07	142.93	-83.44
1987	100.84	0.27	257.13	-156.56
1988	116.88	-4.79	297.05	-175.38

Source: IMF, IFS tape.
Notes: H/H = - CF/H+ (difference betw.
claims on govt & govt deposits/H)+ Other
H = 14, CF = 16e, net govt = 12a - 16d.

MOROCCO

Table 4: Decomposition of Changes in the Monetary Base

Year	(1) % Change Monetary Base	(2) Of which is due to CF	(3) Of which is due to net Govt	(4) Other (1-2-3)
1948				
1949				
1950				
1951				
1952				
1953				
1954				
1955				
1956				
1957				
1958				
1959	5.60		-0.55	
1960	13.74		-6.24	
1961	4.39		11.44	
1962	9.20		17.00	
1963	14.53		17.66	
1964	-1.33		10.79	
1965	13.99		2.13	
1966	-0.81		1.31	
1967	12.94		18.91	
1968	14.02	-2.11	15.02	0.82
1969	14.10	5.51	9.90	4.21
1970	8.04	-0.26	6.97	2.61
1971	10.84	-4.39	-3.76	3.80
1972	18.74	3.61	8.75	-10.93
1973	14.70	0.72	5.83	-0.57
1974	20.76	0.29	6.55	4.93
1975	15.00	0.00	17.93	-12.67
1976	21.74	-1.19	13.44	-11.88
1977	15.50	-0.28	21.91	9.94
1978	15.37	-0.54	16.40	39.29
1979	16.50	-0.38	9.99	24.45
1980	5.18	-0.23	22.35	-22.68
1981	13.48	-1.14	23.93	-3.00
1982	6.90	-1.60	13.34	-160.80
1983	13.27	-1.50	27.57	10.80
1984	11.50	-2.48	8.99	2.45
1985	7.52	6.45	-0.27	-21.53
1986	23.75	0.00	-18.79	22.87
1987	5.43	0.00	-10.35	-19.58
1988	15.74	0.00	2.65	-0.29

Source: IMF, IFS tape.
Notes: H/H = - CF/H+ (difference betw. claims on govt & govt deposits/H)+ Other
H = 14, CF = 16e, net govt = 12a - 16d.

RWANDA

Table 4: Decomposition of Changes in the Monetary Base

Year	(1) % Change Monetary Base	(2) Of which is due to CF	(3) Of which is due to net Govt	(4) Other (1-2-3)
1948				
1949				
1950				
1951				
1952				
1953				
1954				
1955				
1956				
1957				
1958				
1959				
1960				
1961				
1962				
1963				
1964				
1965	25.87		31.23	
1966	14.91		25.35	
1967	17.33	-12.33	10.84	18.81
1968	3.24	1.34	20.38	-18.48
1969	13.77	8.03	11.71	-5.97
1970	8.47	-0.34	-21.05	29.86
1971	15.75	1.36	7.32	7.07
1972	-1.87	1.23	20.84	-23.94
1973	39.47	0.11	11.46	27.89
1974	21.72	0.67	7.75	13.31
1975	1.58	0.45	-26.01	27.14
1976	61.73	-3.45	-6.46	71.64
1977	13.58	0.18	-18.65	32.06
1978	2.19	0.60	-4.03	5.62
1979	43.88	0.46	-4.35	47.77
1980	-6.49	0.29	-31.24	24.45
1981	-12.71	-0.98	6.97	-18.70
1982	3.92	0.55	25.11	-21.74
1983	11.44	-0.79	28.56	-16.33
1984	6.13	0.40	0.04	5.69
1985	11.98	0.28	-7.34	19.03
1986	13.48	0.13	9.29	4.07
1987	10.80	0.07	25.27	-14.54
1988	-10.20	0.07	-0.39	-9.88

Source: IMF, IFS tape.

Notes: H/H = - CF/H+ (difference betw. claims on govt & govt deposits/H)+ Other

H = 14, CF = 16e, net govt = 12a - 16d.

TUNISIA

Table 4: Decomposition of Changes in the Monetary Base

Year	(1) % Change Monetary Base	(2) Of which is due to CF	(3) Of which is due to net Govt	(4) Other (1-2-3)
1948				
1949				
1950				
1951				
1952				
1953				
1954				
1955				
1956				
1957				
1958				
1959	19.63		3.63	
1960	14.33		1.04	
1961	16.43		20.47	
1962	-1.11		20.71	
1963	11.85	-1.60	35.07	-21.62
1964	-3.32	-5.14	3.18	-1.35
1965	6.13	-1.73	8.91	-1.06
1966	20.35	-1.86	12.16	10.04
1967	2.49	-0.67	-2.53	5.69
1968	13.52	0.00	-1.05	14.57
1969	5.41	0.07	6.58	-1.24
1970	3.14	0.04	-4.78	7.88
1971	31.06	-0.21	-7.42	38.69
1972	13.61	0.10	-27.00	40.52
1973	18.35	0.23	-12.88	31.01
1974	30.00	0.16	5.92	23.91
1975	14.57	0.14	0.72	13.70
1976	6.79	0.13	11.97	-5.31
1977	4.74	0.05	-5.56	10.25
1978	17.39	-0.00	-0.53	17.92
1979	9.72	-0.09	-0.20	10.01
1980	12.19	-0.06	-10.58	22.83
1981	26.29	-0.04	-4.85	31.17
1982	23.08	-0.03	0.53	22.58
1983	17.55	-0.02	-3.58	21.15
1984	10.26	-0.02	2.01	8.27
1985	8.80	-0.04	0.71	8.12
1986	1.00	-0.04	0.90	0.14
1987	7.87	1.39	3.20	3.28
1988	6.36	-2.04	-8.64	17.05

Source: IMF, IFS tape.

Notes: H/H = - CF/H+ (difference betw. claims on govt & govt deposits/H)+ Other
H = 14, CF = 16e, net govt = 12a - 16d.

MADAGASCAR

Table 4: Decomposition of Changes in the Monetary Base

Year	(1) % Change Monetary Base	(2) Of which is due to CF	(3) Of which is due to net Govt	(4) Other (1-2-3)
1948				
1949				
1950				
1951				
1952				
1953				
1954				
1955				
1956				
1957				
1958			N.A.	
1959				
1960				
1961				
1962				
1963	1.86			
1964	7.25			
1965	-3.60			
1966	6.26			
1967	9.16			
1968	0.05			
1969	4.52			
1970	19.07			
1971	-1.27			
1972	15.25			
1973	5.58			
1974	18.21			
1975	6.78			
1976	14.11			
1977	12.09			
1978	33.10			
1979	-2.75		N.A.	
1980	35.09	-0.31		35.40
1981	34.15	-0.48		34.63
1982	-1.15	-0.75		-0.40
1983	-4.82	-0.15		-4.67
1984	9.24	1.24		8.00
1985	4.22	-0.10		4.32
1986	70.43	0.24		70.19
1987	20.71	0.01		20.70
1988	3.69	0.00		3.69

Source: IMF, IFS tape.
Notes: H/H = - CF/H+ (difference betw. claims on govt & govt deposits/H)+ Other
H = 14, CF = 16e. 16d is unavailable.

DOMINICAN REPUBLIC

Table 5: Decomposition of Changes in M2

Year	(1) Percentage Change in M2	(2) Of which is due to CF	(3) Of which is due to DCG	(4) Other (1-2-3)
1948				
1949				
1950				
1951	17.74		-17.93	
1952	18.05		13.50	
1953	-3.72		-24.87	
1954	30.94		-8.56	
1955	15.19		18.99	
1956	4.67		15.66	
1957	14.17		1.92	
1958	10.34		9.89	
1959	-10.69		8.75	
1960	0.39		-6.53	
1961	-2.09		27.89	
1962	10.76		-8.78	
1963	12.50	-3.36	39.43	-23.57
1964	-6.41	3.24	11.94	-21.59
1965	32.81	-4.07	2.85	34.03
1966	-15.49	-0.05	0.36	-15.79
1967	4.81	-0.43	-15.34	20.58
1968	21.88	-5.15	8.43	18.59
1969	14.99	-2.62	3.54	14.06
1970	19.25	3.64	5.42	10.19
1971	14.93	1.97	7.98	4.98
1972	23.31	-1.14	7.88	16.56
1973	22.95	-1.74	6.48	18.21
1974	43.69	3.26	16.44	23.98
1975	16.78	0.04	-3.08	19.82
1976	3.28	-0.05	-3.15	6.48
1977	14.89	-0.06	5.87	9.08
1978	-1.42	-0.17	4.73	-5.98
1979	16.51	-0.22	8.24	8.49
1980	1.71	-0.35	9.36	-7.30
1981	13.88	0.32	25.10	-11.54
1982	14.79	-0.10	18.56	-3.67
1983	9.19	-1.48	18.50	-7.83
1984	29.43	1.69	5.63	22.11
1985	19.38	-3.02	-2.47	24.87
1986	65.43	0.66	-0.43	65.20
1987	15.13	-9.63	2.99	21.77
1988	-100.00	7.14	-31.11	-76.04

Source: IMF, IFS tapes.
Notes: M2 = money(34) + quasi-money(35).
CF= 16e, DCP= domestic credit govt(32an).
Other = ΔM2/M2 - (-Δ CF/M2) -ΔDCP/M2

(9)

EL SALVADOR

Table 5: Decomposition of Changes in M2

Year	(1) Percentage Change in M2	(2) Of which is due to CF	(3) Of which is due to DCG	(4) Other (1-2-3)
1948				
1949	17.76		-6.45	
1950	19.21		-0.25	
1951	3.32		2.61	
1952	19.02		-1.71	
1953	5.00		-0.57	
1954	12.75		-9.96	
1955	0.58		-4.61	
1956	16.36		-0.24	
1957	4.69		-4.52	
1958	1.94		5.63	
1959	9.33		11.19	
1960	-1.88		1.17	
1961	3.08		10.36	
1962	7.63		6.19	
1963	22.44		2.12	
1964	12.86		-3.55	
1965	3.64		-4.42	
1966	9.14		6.09	
1967	2.15		1.96	
1968	4.21		2.68	
1969	10.28		5.57	
1970	5.98		-3.06	
1971	10.53		2.18	
1972	22.62		3.59	
1973	18.65		-4.32	
1974	16.57		11.07	
1975	21.18		0.64	
1976	30.88		-1.65	
1977	13.17		-0.37	
1978	11.86		1.39	
1979	9.12		15.39	
1980	4.81		13.43	
1981	10.57		27.48	
1982	14.05		-4.74	
1983	10.60	1.62	-2.69	11.68
1984	18.47	0.00	0.91	17.56
1985	26.89	-3.54	3.22	27.21
1986	28.47	-1.86	-8.93	39.26
1987	6.76	-12.28	4.15	14.89
1988	11.50	-1.57	-2.54	15.61

Source: IMF, IFS tapes.
Notes: M2 = money(34) + quasi-money(35).
CF= 36e, DCP= domestic credit govt(32an).
Other = M2/M2 - (- CF/M2) - DCP/M2

PARAQUAY

Table 5: Decomposition of Changes in M2

Year	(1) Percentage Change in M2	(2) Of which is due to CF	(3) Of which is due to DCG	(4) Other (1-2-3)
1948				
1949				
1950				
1951				
1952				
1953	49.21		26.74	
1954	24.28		-17.39	
1955	36.60		-12.20	
1956	27.17		8.00	
1957	6.93		3.24	
1958	26.78		9.88	
1959	4.13		3.37	
1960	5.46		0.07	
1961	29.76		2.80	
1962	5.16	-9.51	-3.41	18.08
1963	19.17	-7.28	7.88	18.57
1964	26.48	-1.70	8.22	19.96
1965	16.75	-6.40	1.28	21.86
1966	7.94	2.64	-0.66	5.96
1967	31.61	1.80	9.18	20.63
1968	-2.21	2.01	1.05	-5.28
1969	17.28	0.68	-0.96	17.56
1970	13.92	0.50	-0.83	14.26
1971	12.84	0.04	2.29	10.51
1972	23.61	-0.53	6.19	17.95
1973	28.98	2.67	-0.23	26.54
1974	20.90	0.29	-7.79	28.40
1975	26.23	0.02	-1.56	27.77
1976	23.36	-0.00	-0.99	24.35
1977	31.48	0.00	-5.28	36.76
1978	30.50	0.01	-8.32	38.81
1979	24.20	0.00	-8.90	33.10
1980	34.64	0.00	-2.59	37.23
1981	19.45	0.00	9.62	9.83
1982	5.68	0.00	2.55	3.13
1983	16.74	0.00	10.15	6.59
1984	16.81	0.00	3.82	12.99
1985	20.80	-0.00	-0.13	20.93
1986	27.37	0.00	0.54	26.34
1987	35.00	0.00	0.19	34.81
1988	20.00	0.00	-3.47	23.48

Source: IMF, IFS tapes.
Notes: M2 = money(34) + quasi-money(35).
CF= 36e, DCP= domestic credit govt(32an).
Other = M2/M2 - (- CF/M2) - DCP/M2

INDONESIA

Table 5: Decomposition of Changes in M2

Year	(1) Percentage Change in M2	(2) Of which is due to CF	(3) Of which is due to DCG	(4) Other (1-2-3)
1948				
1949				
1950				
1951				
1952				
1953				
1954				
1955				
1956				
1957				
1958				
1959				
1960				
1961				
1962				
1963				
1964				
1965				
1966	733.33		462.96	
1967	139.56		36.89	
1968	138.22		10.02	
1969	81.70	-6.70	-1.32	89.72
1970	41.62	4.37	2.79	34.46
1971	41.56	2.27	4.24	35.05
1972	48.90	3.27	-11.33	56.96
1973	42.71	1.29	-3.52	44.93
1974	46.33	-1.53	-12.20	60.05
1975	39.02	-0.02	12.90	26.14
1976	31.11	-2.14	-16.70	49.96
1977	18.21	-0.60	-4.53	23.34
1978	21.98	0.05	-1.75	23.67
1979	34.97	-0.77	-18.34	54.08
1980	49.40	0.33	-30.69	79.75
1981	25.93	0.81	-25.24	50.36
1982	14.10	0.11	-5.19	19.18
1983	32.47	-0.39	2.31	30.55
1984	22.27	-1.11	-21.08	44.47
1985	29.22	0.33	-5.89	34.77
1986	19.15	0.08	2.36	16.71
1987	22.78	0.25	6.01	16.52
1988	24.09	0.17	-0.84	24.77

Source: IMF, IFS tapes.
Notes: M2 = money(34) + quasi-money(35).
CF= 16e, DCP= domestic credit govt(32an).
Other = M2/M2 - (- CF/M2) - DCP/M2

PAKISTAN

Table 5: Decomposition of Changes in M2

Year	(1) Percentage Change in M2	(2) Of which is due to CF	(3) Of which is due to DCG	(4) Other (1-2-3)
1948				
1949	2.68			
1950	9.91			
1951	25.95			
1952	-12.74		16.21	
1953	11.69		10.28	
1954	10.31		7.55	
1955	14.09		0.54	
1956	11.94	-5.92	13.38	4.49
1957	7.03	-5.78	16.23	-3.42
1958	5.90	-1.15	6.96	0.09
1959	8.44	0.87	-1.05	8.62
1960	7.96	0.71	4.97	2.28
1961	-3.96	-6.41	0.95	1.50
1962	9.07	0.76	-0.69	9.00
1963	16.84	-1.26	6.59	11.50
1964	21.45	-0.01	7.75	13.71
1965	11.86	-1.48	6.35	7.00
1966	21.12	0.32	11.97	8.83
1967	3.26	0.10	-0.62	3.77
1968	12.45	-0.62	6.18	6.89
1969	9.55	1.79	3.77	3.99
1970	11.70	-0.81	6.19	6.31
1971	13.77	-0.58	12.88	1.47
1972	17.47	-0.49	6.21	11.74
1973	13.80	-0.81	1.35	13.26
1974	-1.20	-0.75	-2.42	1.96
1975	21.22	-0.46	18.64	3.03
1976	32.20	0.09	10.82	21.29
1977	17.95	-0.68	12.08	6.54
1978	19.84	0.37	16.36	3.12
1979	19.10	-0.64	10.95	8.79
1980	15.70	-0.06	9.31	6.44
1981	11.52	0.17	3.87	7.48
1982	21.83	0.31	15.35	6.17
1983	20.91	-0.22	5.13	16.00
1984	4.65	0.29	6.25	-1.89
1985	14.75	0.14	2.45	12.16
1986	16.07	0.17	7.30	8.60
1987	16.40	-0.10	16.72	-0.21
1988	7.70	0.44	2.51	4.75

Source: IMF, IFS tapes.
Notes: M2 = money(34) + quasi-money(35).
CF= 36e, DCP= domestic credit govt(32an).
Other = M2/M2 - (- CF/M2) - DCP/M2

ZAIRE

Table 5: Decomposition of Changes in M2

Year	(1) Percentage Change in M2	(2) Of which is due to CF	(3) Of which is due to DCG	(4) Other (1-2-3)
1948				
1949				
1950				
1951				
1952				
1953				
1954				
1955				
1956				
1957				
1958				
1959				
1960				
1961				
1962				
1963				
1964	17.78	-6.67	6.67	17.78
1965	16.58	-3.77	39.62	-18.87
1966	27.42	0.00	9.68	17.74
1967	36.71	0.00	2.53	34.18
1968	35.19	0.00	7.41	27.78
1969	16.44	-2.05	-4.11	22.60
1970	22.35	1.18	10.00	11.18
1971	7.69	0.96	15.87	-9.13
1972	21.88	0.89	11.61	9.38
1973	37.73	0.37	9.52	27.84
1974	32.71	0.53	36.70	-4.52
1975	10.02	0.00	24.25	-14.23
1976	38.25	-0.73	66.30	-27.32
1977	59.16	-1.05	45.98	14.23
1978	54.30	-0.99	43.87	11.42
1979	4.94	-0.64	27.74	-22.16
1980	62.78	1.79	20.91	40.08
1981	51.98	-0.19	44.32	7.85
1982	69.93	-0.21	82.74	-12.61
1983	64.78	-4.34	44.89	24.24
1984	38.62	0.93	132.43	-94.74
1985	29.57	-1.00	90.49	-59.93
1986	58.89	0.88	115.68	-57.66
1987	95.86	-0.89	216.09	-119.34
1988	131.18	-3.54	248.07	-113.35

Source: IMF, IFS tapes.
Notes: M2 = money(34) + quasi-money(35).
CF= 36e, DCP= domestic credit govt(32an).
Other = M2/M2 - (- CF/M2) - DCP/M2

KENYA

Table 5: Decomposition of Changes in M2

Year	(1) Percentage Change in M2	(2) Of which is due to CF	(3) Of which is due to DCG	(4) Other (1-2-3)
1948				
1949				
1950				
1951				
1952				
1953				
1954				
1955				
1956				
1957				
1958				
1959				
1960				
1961				
1962				
1963				
1964				
1965				
1966				
1967	10.66		1.75	
1968	11.07		3.79	
1969	19.12		1.60	
1970	27.57		-1.12	
1971	7.30		2.67	
1972	13.71		5.66	
1973	24.67		6.12	
1974	8.64		8.48	
1975	17.12		12.06	
1976	24.06		1.94	
1977	48.15		-1.17	
1978	13.01		11.38	
1979	13.10		2.98	
1980	0.78		1.95	
1981	13.29		17.44	
1982	16.90		21.50	
1983	4.94		-9.33	
1984	12.78		3.83	
1985	6.35		3.14	
1986	32.70	0.0037	19.29	13.40
1987	11.13	-0.0140	12.21	-1.07
1988	8.04	-0.0202	-3.87	11.94

Source: IMF, IFS tapes.
Notes: M2 = money(34) + quasi-money(35).
CF= 36e, DCP= domestic credit govt(32an).
Other = M2/M2 - (- CF/M2) - DCP/M2

MADAGASCAR

Table 5: Decomposition of Changes in M2

Year	(1) Percentage Change in M2	(2) Of which is due to CF	(3) Of which is due to DCG	(4) Other (1-2-3)
1948				
1949				
1950				
1951				
1952				
1953				
1954				
1955				
1956				
1957				
1958				
1959				
1960				
1961				
1962				
1963	3.96		-0.94	
1964	9.93		-3.88	
1965	6.86		9.20	
1966	8.52		-2.93	
1967	15.67		-0.06	
1968	7.30		6.88	
1969	9.30		5.96	
1970	15.64		-8.40	
1971	6.13		-2.03	
1972	11.77		10.91	
1973	3.94		-1.30	
1974	20.82		13.97	
1975	1.86		8.03	
1976	15.97		9.14	
1977	19.93		6.02	
1978	17.07		19.77	
1979	3.18		35.71	
1980	20.60	-0.13	56.30	-35.56
1981	23.93	-0.22	37.53	-13.38
1982	8.90	-0.37	19.28	-10.01
1983	-9.09	-0.07	23.51	-32.54
1984	24.02	0.58	25.63	-2.19
1985	13.27	-0.04	11.03	2.28
1986	25.62	0.09	19.10	6.43
1987	18.45	0.01	37.60	-19.16
1988	22.44	0.00	3.07	19.37

Source: IMF, IFS tapes.

Notes: M2 = money(34) + quasi-money(35).

CF= 16e, DCP= domestic credit govt(32an).

Other = M2/M2 - (- CF/M2) - DCP/M2

MOROCCO

Table 5: Decomposition of Changes in M2

Year	(1) Percentage Change in M2	(2) Of which is due to CF	(3) Of which is due to DCG	(4) Other (1-2-3)
1948				
1949				
1950				
1951				
1952				
1953				
1954				
1955				
1956				
1957				
1958				
1959	0.74		-1.72	
1960	16.81		-1.47	
1961	5.26		5.85	
1962	15.52		13.37	
1963	6.70		10.34	
1964	1.58		5.37	
1965	6.87		0.03	
1966	-0.79		0.79	
1967	9.22		8.00	
1968	12.71	-0.87	8.13	5.46
1969	10.87	2.29	10.59	-2.00
1970	7.89	-0.11	3.36	4.64
1971	12.90	-1.88	1.08	13.70
1972	18.20	1.51	8.35	8.34
1973	16.61	0.30	5.25	11.05
1974	29.31	0.12	14.84	14.35
1975	20.10	0.00	10.07	10.03
1976	18.09	-0.44	8.78	9.75
1977	19.71	-0.11	14.03	5.78
1978	17.66	-0.20	17.94	-0.08
1979	13.85	-0.14	7.26	6.73
1980	10.83	-0.09	12.00	-1.08
1981	16.44	-0.40	12.42	4.43
1982	11.08	-0.55	6.71	4.92
1983	17.69	-0.50	16.73	1.45
1984	10.22	-0.79	3.50	7.51
1985	18.19	2.07	9.19	6.92
1986	15.88	0.00	7.85	8.04
1987	9.73	0.00	3.67	6.06
1988	14.71	0.00	5.01	9.70

Source: IMF, IFS tapes.
Notes: M2 = money(34) + quasi-money(35).
CF= 26e, DCP= domestic credit govt(32an).
Other = M2/M2 - (- CF/M2) - DCP/M2

RWANDA

Table 5: Decomposition of Changes in M2

Year	(1) Percentage Change in M2	(2) Of which is due to CF	(3) Of which is due to DCG	(4) Other (1-2-3)
1948				
1949				
1950				
1951				
1952				
1953				
1954				
1955				
1956				
1957				
1958				
1959				
1960				
1961				
1962				
1963				
1964				
1965	29.42		30.89	
1966	8.16		18.28	
1967	20.11	-9.29	12.15	17.25
1968	5.47	0.99	15.64	-11.16
1969	16.87	5.79	11.03	0.06
1970	21.18	-0.24	-8.63	30.05
1971	13.70	0.86	9.61	3.23
1972	1.78	0.79	19.89	-18.90
1973	35.52	0.07	6.16	29.30
1974	32.81	0.42	14.87	17.52
1975	12.07	0.26	-9.23	21.04
1976	34.17	-1.82	-14.32	50.31
1977	26.01	0.11	-15.88	41.78
1978	10.28	0.35	-3.23	13.16
1979	25.98	0.24	-12.96	38.70
1980	8.09	0.18	-11.25	19.17
1981	4.97	-0.51	1.70	3.78
1982	1.18	0.24	13.58	-12.64
1983	11.77	-0.35	17.04	-4.91
1984	10.05	0.18	-0.79	10.66
1985	17.79	0.12	-0.47	18.14
1986	13.56	0.05	4.16	9.35
1987	10.26	0.03	15.24	-5.01
1988	7.33	0.03	5.74	1.56

Source: IMF, IFS tapes.
Notes: M2 = money(34) + quasi-money(35).
CF= 16e, DCP= domestic credit govt(32an).
Other = M2/M2 - (- CF/M2) - DCP/M2

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TUNISIA

Table 5: Decomposition of Changes in M2

Year	(1) Percentage Change in M2	(2) Of which is due to CF	(3) Of which is due to DCG	(4) Other (1-2-3)
1948				
1949				
1950				
1951				
1952				
1953				
1954				
1955				
1956				
1957				
1958				
1959	30.43	-8.19	2.91	35.71
1960	16.54	0.74	2.73	13.07
1961	12.19	-0.25	10.64	1.80
1962	10.10	-4.31	12.36	2.05
1963	26.38	-0.65	24.57	2.45
1964	3.18	-2.73	2.19	3.72
1965	8.36	0.26	4.98	3.12
1966	13.07	1.92	3.66	7.49
1967	6.37	0.83	-0.85	6.40
1968	12.91	-0.75	1.32	12.33
1969	6.02	-1.25	2.80	4.47
1970	9.15	-1.16	-0.74	11.05
1971	21.15	1.93	-3.28	22.49
1972	16.68	-0.32	-4.97	21.97
1973	20.18	-0.55	-1.95	22.67
1974	28.19	0.08	2.58	25.53
1975	22.25	-0.50	0.73	22.02
1976	15.63	0.66	8.28	6.69
1977	13.44	0.03	2.58	10.82
1978	19.82	0.11	3.85	15.87
1979	16.17	0.06	3.43	12.68
1980	18.54	-0.00	0.40	18.15
1981	22.73	-0.18	2.50	20.42
1982	19.87	-0.86	2.89	17.85
1983	16.39	0.12	2.24	14.04
1984	11.68	-0.07	3.90	7.85
1985	14.40	-0.13	3.74	10.79
1986	4.91	-0.78	2.32	3.37
1987	14.92	1.71	2.83	10.38
1988	17.52	-2.50	-1.17	21.19

Source: IMF, IFS tapes.
Notes: M2 = money(34) + quasi-money(35).
CF= 36e, DCP= domestic credit govt(32an).
Other = M2/M2 - (- CF/M2) - DCP/M2

Table 6: Counterpart Funds as a Share of Government Expenditure Using the IMF-IFS Data

-Country-	1970	1975	1980	1985	1988
	-Year-				
Dominican Republic	.050	-NA-	-NA-	-NA-	-NA-
El Salvador	-NA-	-NA-	-NA-	.070	-NA-
Paraguay	.059	-NA-	-NA-	-NA-	-NA-
Indonesia	.076	.070	.007	.007	-NA-
Pakistan	.104	.083	.057	.010	.002
Zaire	.016	.003	.001	-NA-	-NA-
Kenya	-NA-	-NA-	-NA-	.001	.001
Morocco	.006	.000	.007	-NA-	-NA-
Tunisia	-NA-	.018	.008	-NA-	-NA-

Notes: CF is line 16e except for Morocco where CF is line 26e. G is government expenditures from line 82. NA means the data are not available for that year.

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